

## FLAHERTY & CRUMRINE PREFERRED INCOME FUND

To the Shareholders of Flaherty & Crumrine Preferred Income Fund:

We begin with good news about distributions on your shares of PFD—the Fund finished fiscal 2010 with a bit of extra income, so shareholders of record on December 23, 2010 received an additional \$0.03 per share. In addition, the regular monthly distribution was increased to \$0.09 from \$0.089 per share beginning with the December dividend<sup>1</sup>.

During the Fund's final fiscal quarter, the portfolio once again turned in solid performance. For the three-month period ending November 30, 2010, the Fund's return on net asset value was +5.5%. Over the entire fiscal year, the return on NAV was +31.5%. The table below presents these and other performance measures of interest to investors.

### TOTAL RETURN ON NET ASSET VALUE FOR PERIODS ENDED NOVEMBER 30, 2010

	Actual Returns			Average Annualized Returns			
	Three Months	Six Months	One Year	Three Years	Five Years	Ten Years	Life of Fund <sup>(1)</sup>
Flaherty & Crumrine Preferred Income Fund . . . . .	5.5%	18.3%	31.5%	7.4%	3.6%	7.0%	9.5%
Barclays Capital U.S. Aggregate Index <sup>(2)</sup>	-0.1%	3.9%	6.0%	6.4%	6.2%	6.2%	6.9%
S&P 500 Index <sup>(3)</sup> . . . . .	13.1%	9.5%	9.9%	-5.2%	1.0%	0.8%	8.6%

(1) Since inception on January 31, 1991.

(2) The Barclays Capital U.S. Aggregate Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. It is generally considered to be representative of the domestic, investment-grade, fixed-rate, taxable bond market. Unless otherwise noted, index returns reflect the reinvestment of dividends and capital gains, if any, but do not reflect fees, brokerage commissions or other expenses of investing. This index was formerly known as the Lehman Brothers U.S. Aggregate Index.

(3) The S&P 500 is a capitalization-weighted index of 500 common stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Fund's strong performance during the quarter was accomplished despite a weak market for US Treasury bonds and continued uncertainty about changes in regulation of the banking industry.

Conditions in the market for preferred securities are still positive. Demand is broad based and steady, while most participants expect the size of the market to decline (at least over the near-term). The market has also been boosted by steady improvement in the financial strength of many issuers as, corporate profitability has steadily improved.

<sup>1</sup> A more in-depth discussion of the dividend and other important topics can be found in the section which follows our letter.

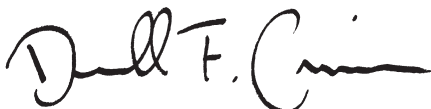
*Short-term* interest rates remain near zero as economic activity remains positive but stubbornly slow. Unemployment rates are high, and the impact of fiscal and monetary actions has been more muted than desired. We anticipate short-term interest rates (and hence the cost of the Fund's leverage) will remain low over the near-term; however, eventually they will go up. Our view is detailed in the Quarterly Economic Outlook available on the Fund's website.

Yields on *long-term* U.S. Treasury bonds increased almost 60 basis points during the period; prices fell roughly 10%. Clearly, concerns about a pick-up in economic activity, inflation, or both, have become more widespread. In the past, a move of this magnitude typically caused some corresponding drop in the prices of preferred securities. Obviously, the recent period was not typical—most preferred prices actually went up in the face of falling bond prices. The correlation between prices of preferred securities and treasury bonds used to be reliably high, but this has not been the case for much of the past three years (a major reason the Fund suspended its hedging strategy in autumn 2008).

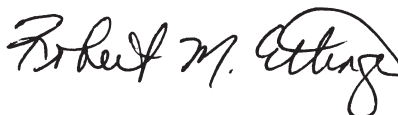
As discussed previously, the financial crisis brought to light a need to rethink the role of capital in the banking industry. Regulators and policy makers are debating the amount and composition of capital necessary to prevent a repeat of the crisis. Preferred securities play a very important part in the debate. This is a complex matter and there are a lot of chefs in the kitchen; it will likely take many more months before the process is complete. However, some change is certain and we are managing the portfolio to reflect things we know and some we anticipate. We remain optimistic the ultimate outcome will be beneficial over the long term.

As always, we encourage you to visit [www.preferredincome.com](http://www.preferredincome.com) to read our Quarterly Economic Update as well as a more detailed discussion of factors affecting the wonderful world of preferred securities.

Sincerely,



Donald F. Crumrine  
Chairman



Robert M. Ettinger  
President

January 10, 2011

## DISCUSSION TOPICS

### The Fund's Portfolio Results and Components of Total Return on NAV

The table below reflects the performance of each investment technique available for use by the Fund to achieve its objective, namely: (a) investing in a portfolio of securities; (b) hedging that portfolio of securities against significant increases in long-term interest rates (see the following discussion on the status of the Fund's interest rate hedging strategy); and (c) utilizing leverage to enhance returns to shareholders. Next, we compute the impact of the Fund's operating expenses. All of the parts are summed to determine total return on NAV.

#### Components of PFD's Total Return on NAV for the Fiscal Year Ended November 30, 2010

	<i>Six Months*</i>	<i>One Year</i>
Total Return on Unleveraged Securities Portfolio (including principal and income) .....	+12.9%	+22.4%
Return from Interest Rate Hedging Strategy .....	N/A	N/A
Impact of Leverage (including leverage expense) .....	+6.2%	+10.7%
Expenses (excluding leverage expense) .....	-0.8%	-1.6%%
<i>Total Return on NAV</i>	<b>+18.3%</b>	<b>+31.5%</b>

\* Actual, not annualized.

The following table displays returns for the various segments of the preferred securities market as measured by BofA Merrill preferred indices, over both the past six months and the Fund's fiscal year ended November 30<sup>th</sup>. During these periods, the preferred market continued the price recovery that began in early 2009, but at a somewhat slower pace. As can be seen by comparing the total return on the Fund's securities portfolio (the first row of the above table) to the index results below, the Fund's portfolio outperformed all segments of the preferred market over its fiscal year ending November 30<sup>th</sup>, even excluding the impact of leverage. During the past six months, the Fund's (unleveraged) securities portfolio outperformed all segments of the preferred market except adjustable rate preferred securities, which constitute only about 2.5% of the entire preferred market and just 2.3% of the Fund's portfolio.

#### Total Returns of Bank of America Merrill Lynch Preferred Securities Indices\* for the Periods Ended November 30, 2010

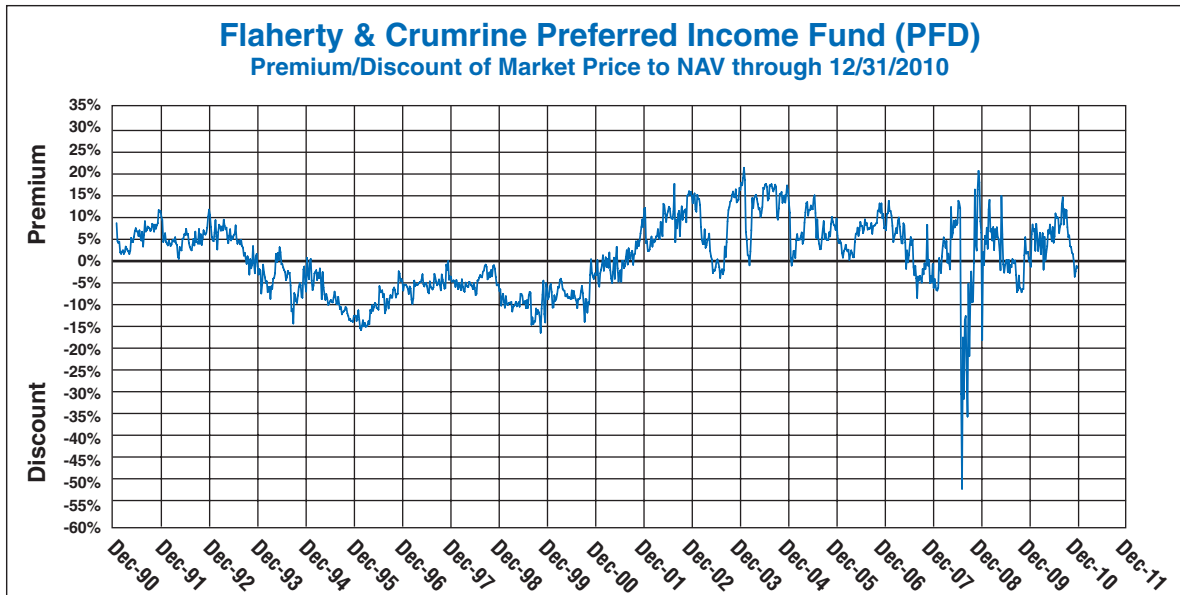
	<i>Six Months</i>	<i>One Year</i>
BofA Merrill Lynch 8% Capped DRD Preferred Stock Index <sup>SM</sup> .....	+8.2%	+16.9%
BofA Merrill Lynch 8% Capped Hybrid Preferred Securities Index <sup>SM</sup> .....	+10.8%	+18.8%
BofA Merrill Lynch 8% Capped Corporate U.S. Capital Securities Index <sup>SM</sup> ..	+10.8%	+19.7%
BofA Merrill Lynch Adjustable Preferred Stock, 7% Constrained Index <sup>SM</sup> ....	+13.5%	+16.3%

\* The Bank of America Merrill Lynch 8% Capped DRD Preferred Stock Index<sup>SM</sup> includes investment grade preferred securities issued by both corporations and government agencies that qualify for the corporate dividends received deduction with issuer concentration capped at a maximum of 8%. The Bank of America Merrill Lynch 8% Capped Hybrid Preferred Securities Index<sup>SM</sup> includes taxable, fixed-rate, U.S. dollar-denominated investment-grade, preferred securities listed on a U.S. exchange with issuer concentration capped at 8%. The Bank of America Merrill Lynch 8% Capped Corporate U.S. Capital Securities Index<sup>SM</sup> includes investment grade fixed rate or fixed-to-floating rate \$1,000 par securities that receive some degree of equity credit from the rating agencies or their regulators with issuer concentration capped at a maximum of 8%. The Bank of America Merrill Lynch Adjustable Preferred Stock, 7% Constrained Index<sup>SM</sup> includes adjustable rate preferred securities issued by U.S. corporations and government agencies with issuer concentration capped at a maximum of 7%. All index returns include interest and dividend income, and, unlike the Fund's returns, are unmanaged and do not reflect any expenses.

As shown in the first table, the Fund's performance demonstrates how leverage again benefited common stock shareholders over the past year – increasing current income and magnifying the positive returns over the Fund's fiscal 2010. Although leverage can adversely impact Fund results in unfavorable market environments, during the recent fiscal year leverage assisted the Fund's NAV in significantly outperforming returns available in the preferred securities market, as measured by the various BofA Merrill preferred indices.

### Total Return on Market Price of Fund Shares

While our focus is primarily on managing the Fund's investment portfolio, an investor's actual return is comprised of monthly dividend payments plus changes in the Fund's *market price*. During the twelve months ending November 30, 2010, the total return on market price of Fund shares was +43.6%.



In a perfect world, the market price of Fund shares would closely track the Fund's net asset value. As can be seen from the graph above, this often is not the case. For most of the past year the *market price* has been above the NAV (in market parlance, "trading at a premium"). Because the Fund began fiscal 2010 with its market price below NAV ("trading at a discount") and ended the fiscal year above, the total return earned on market price exceeded the total return on NAV.

Based on a closing price of \$11.62 on December 31<sup>st</sup>, the current annualized yield on the market price of the Fund's shares (assuming the current monthly distribution of \$0.09 does not change) is 9.29%. In our opinion, this distribution rate measures up favorably with most comparable investment opportunities.

### Preferred Market Conditions

By most measures, preferred market trading conditions are back to pre-crisis levels. Trading volumes and bid/offer spreads, though never robust compared to other major market segments, have returned to more customary levels. In our opinion, preferred securities remain attractively valued relative to other fixed income securities; plus, we are still finding opportunities to add value through credit research and security selection.

Credit conditions continue to improve. The economy is growing fast enough for profits to rebound nicely, but not fast enough to generate much demand for new capital spending by corporations. Households are paying down debt, driving investors who had previously purchased mortgage and credit card debt into other asset classes. Corporations are showing strong cash flow, improved interest coverage, and growing liquidity. Loan quality is improving, with delinquencies and charge-offs falling in almost all loan categories—though commercial real estate remains an important exception. Overall, credit default rates continue to trend lower. The result is good demand for preferred securities, little new issuance, and tighter spreads. We think these factors will continue to benefit the markets for some time to come.

Trading activity in the “retail” segment of the market<sup>2</sup> has been boosted by the rapid growth of exchange traded funds. ETF’s that invest primarily in preferred securities are “rules based” in that there is limited discretion about how a fund is managed—the objective is to closely track a specific index. We sometimes scratch our heads as to the appeal of these funds, but they do provide a healthy dose of liquidity, and they have attracted a lot of new investors to the preferred market.

In the aftermath of the financial crisis, new legislation (much of which has yet to be implemented) has resulted in wide ranging changes to the banking industry. Since preferred securities issued by banks comprise over sixty percent of the overall market, we watch this legislation with great interest. In the topic which follows, we discuss the most relevant regulatory changes; here, we’ll focus on market impact.

One thing we know for sure—certain types of preferred securities will eventually become obsolete. It is now clear that regulatory changes will diminish the benefits of some securities to the banks that issued them, and as a result, it is widely assumed many preferred securities will be retired at the earliest practical opportunity. The prospects of issuer redemptions have provided a boost to the market.

Of course, this wouldn’t be the preferred market without a fair share of hazards. In some cases, buried deep in the documentation of a security, there is language which permits the issuer to exercise an early redemption, at par, if certain events occur. Without such a provision, the issuer would either have to pay a premium to call the issue, or may not be permitted to call it at all until some future date. Such events, which seemed remote just a couple years ago, have in fact occurred in response to changes in financial regulation.

Market participants appear to have adjusted expectations about early redemption of *non-bank* preferred securities as well, though for different reasons. Recall that companies choose to issue preferred securities in part because it can improve the ratings on its debt, which in turn can reduce the all-in cost of its capital (since preferred is ranked “junior” to debt, the debt is viewed to be more secure). The major rating agencies have become less inclined to look favorably on certain types of preferred securities, hence non-bank issuers may also be inclined to retire certain preferred issues sooner than expected. The redemption terms of these non-bank issues haven’t changed, but the market now perceives the likelihood of issuer redemption to be higher and as a result, prices adjust to reflect the perception.

While it has become clear that certain types of preferred securities are destined to become a footnote in financial textbooks, a viable replacement has yet to emerge. A lot of smart people are hard at work to build a better preferred, and we’re optimistic they will succeed (though it may take a few iterations). You can bet we will be involved!

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<sup>2</sup> In general, rules for ETF’s that invest primarily in preferred securities require the funds to invest only in securities listed on a national stock exchange; such issues comprise roughly half of the preferred market.

All of this leads to one unavoidable conclusion: *during the next few years, market participants, including the Fund, will need to find replacements for a significant number of high yielding securities.* At this juncture, of course, we cannot tell how the Fund will weather this reinvestment risk.

## **Update on Regulatory and Capital Reform for Banks**

As we discussed in detail in the Fund's semiannual report from May 2010, banks face significant new regulation and stiffer capital requirements. We will quickly summarize the key features of bank regulatory reform from the Dodd-Frank bill and bank capital requirements from the Basel Committee on Bank Supervision—both from the perspective of preferred investors.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) makes significant changes to banks' operations and capital requirements. Most importantly for preferred investors, it eliminates trust preferred securities (TruPS) from Tier 1 capital for most banks the Funds would invest in. (Tier 1 capital is one of the primary measures of capital for a financial company; it includes common equity, retained earnings, qualifying preferred capital, and regulatory assets). The new rules phase in starting from 2013 through 2015. This change in regulatory treatment for TruPS makes it likely that most, though not all, TruPS will be called between 2013 and 2016, as banks replace those instruments with qualifying forms of Tier 1 capital. As of this writing, roughly 23% of the Fund's portfolio is invested in trust preferred securities issued by U.S. banks.

Along with changes made by lawmakers in the U.S., the Basel Committee on Banking Supervision in recent months has released its Basel III framework on bank capital. (This committee sets international banking standards that are subsequently adopted by national regulators, including the U.S.). These new rules will sharply increase the amount of common equity capital held by banks, while leaving an important role for preferred securities.

Currently, banks must hold at least 2.5% of risk-weighted assets (RWA) in the form of common equity. (The U.S. minimum is 4% common equity, and most banks carry substantially more than the minimum.) When Basel III is fully phased in, minimum common equity will rise to 4.5% of RWA. Coupled with some additionally required "capital buffers," we suspect that U.S. banks typically will hold 8-10% common equity and at least 10-12% Tier 1 capital, two to four percentage points higher than before the financial crisis. That's a lot more common equity providing credit support to preferred securities, which will comprise much of the difference between total Tier 1 and Tier 1 common equity.

Another likely, but still undecided, feature of the Basel III rules is a provision to impose "loss absorbency" on any non-common Tier 1 capital instruments. The theory is that all Tier 1 capital should be able to absorb losses on both a "gone concern" basis (i.e., in bankruptcy or receivership) *and* on a "going-concern" basis. Historically, preferred securities have provided substantial loss absorbency upon failure of a firm, since all preferred claims are subordinate to claims of depositors and senior creditors. However, preferreds are—strictly by their contractual terms—only moderately loss absorbing on a going concern basis, because the issuer can defer dividend payments but not eliminate the preferred liability outright in times of strain. The Basel Committee wants to give regulators the ability to either convert preferreds to common stock or write off the preferred liability if they believe the bank is no longer viable.

We have written a lengthy comment letter to the Basel Committee on loss absorbency. Interested readers will find it on the Fund's website or at the Basel Committee website at <http://www.bis.org/publ/bcbs174/fac.pdf>. Suffice to say that we think the proposed loss absorption provision for bank preferreds is unnecessary in the United States, and perhaps elsewhere. Nonetheless, if regulators

insist on it, we think a properly designed mechanism to convert preferred into common stock would be acceptable to preferred investors, while a write-off mechanism would not. We await the Committee's decision on this sometime in 2011.

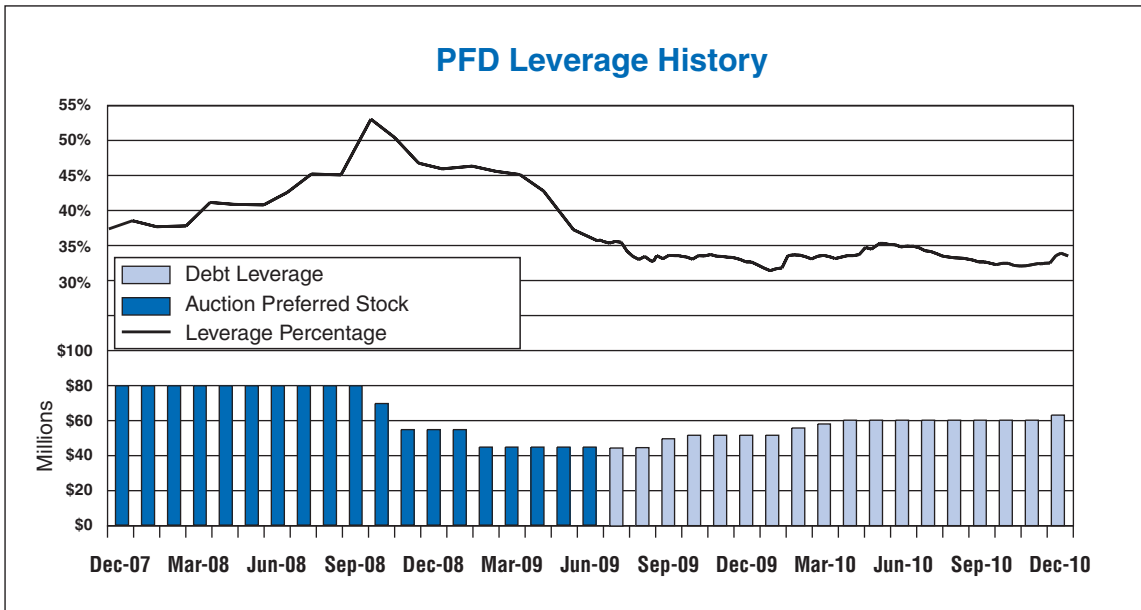
Overall, the new regulatory framework being imposed on banks by Dodd-Frank and Basel III will force banks to hold more capital or take less risk, or both. With respect to bank capital, regulators are requiring substantially more common equity capital than before, while retaining a meaningful role for preferred securities. These developments are broadly supportive for bank preferreds, though they do increase regulatory risk. As the new rules get implemented over the next several years, there will be numerous changes and opportunities awaiting preferred investors.

### The Fund's Leverage

Leverage is an important part of the Fund's strategy to produce high current income. Over time, the cost of leverage is typically lower than the yield on the Fund's portfolio. The difference between what the Fund earns on its investments and pays on the money it borrows increases the income available to common shareholders. Over the past fiscal year, the Fund has paid an average interest rate of 1.443% on its borrowed money. Given the much higher current yields generated by the Fund's portfolio, this use of leverage had a meaningful positive impact on the Fund's dividends to common shareholders.

In addition to economic considerations, there is a set of rules that govern leverage (most importantly, the terms and conditions of the Fund's leverage agreement with its lender, and all relevant securities laws). We take all of these factors into consideration as we manage the leverage *and* the assets of the Fund.

There are two useful measures of how much leverage the Fund has in place. The first is simply the total dollar amount of leverage. The other measure is the ratio of the Fund's assets financed by that leverage (in other words, the amount of leverage divided by total assets). The chart below presents both measures of leverage over the past three years.



When the leverage was comprised entirely of auction preferred stock, the *amount* of leverage rarely changed. As a result, the *percentage* of the Fund's leverage to total net assets varied as the value the portfolio moved up or down. As can be seen in the chart, the leverage percentage climbed steadily as the financial crisis unfolded from 2007 through early 2009 and the value of the Fund's investment portfolio fell.

As the leverage ratio rose to unsustainable levels, the Fund sold assets and used the proceeds to reduce leverage. While this meant that monthly distributions to shareholders had to be cut, it also served to reduce the NAV and market price risk to the Fund's common shareholders.

With debt leverage, the Fund now has the ability to *increase* the amount borrowed by the Fund (within certain limits!). This is important because the dramatic recovery in asset prices meant the Fund could comfortably borrow more and use the money to purchase additional securities. Throughout 2010, the Fund continued to increase its leverage balances. These increases, at very favorable interest rates, allowed the Fund to increase its monthly dividend three times since December 2009, for a total of 25% in cumulative increases.

The "right" percentage of leverage in a fund is never a simple matter to determine. Type of borrowing, the cost of funds and market conditions all will be factors to consider. At present, we are comfortable with the leverage percentage used by the Fund, and we will consider increasing or decreasing the amount of borrowing based on future market conditions. Of course, we continuously monitor our leverage balances and try to use leverage in a manner consistent with the Fund's objective.

### **Monthly Distributions to Fund Shareholders**

The Fund makes monthly distributions of income to shareholders consistent with the objective of the Fund to provide high current income. The Fund is a regulated investment company, and as such, there are a number of tax laws that require the Fund to distribute almost all of its net investment income to shareholders each year. If the Fund were to not satisfy the minimum distribution requirements, it could risk its pass-through status and perhaps face financial penalties.

Even though these rules are well-defined, we still believe that there is a bit of art involved in setting dividend policy. One approach to distributions would be for the Fund to simply pay out its net earnings each month. Because of the uneven nature of the Fund's income and expenses, this would likely result in distribution rates that would change every month. This approach has never seemed terribly appealing to us.

We believe our shareholders are better served by a more stable level of monthly distributions. In striving for more stability and to reflect the inherent uncertainty in predicting future net earnings, in any particular month the Fund may pay out less than the amount earned for the same month; in other months the distribution may be comprised of current month's earnings *plus* income from prior months.

The rules mentioned above also impose a specific time-frame on the decisions about distributions, as they require true-up over each fiscal year. If the Fund has excess income at the end of this annual period, the Fund must make decisions that balance the goal of income stability and the requirements imposed by law. The Fund has always met the legal distribution requirements, but many times in the past the Fund has decided to not exceed the minimum requirements with the intent of "carrying over" a bit of income to the next fiscal-year period. Given that the minimum requirements are quite high, the carryover can never be more than a modest amount (less than one-month's dividend). There is an economic cost associated with this decision in the form of an excise tax on portions of the undistributed amounts, but we believe this cost is minimal and more than offset by the benefits of a more stable distribution rate over time. Details on the amount of undistributed net investment income and the incurrence of any related excise tax, if applicable, are available in the Notes to the financial statements.



As mentioned above, we believe this is more art than science, but the goal of high current income that is sustainable over a reasonable period of time seems to us consistent with trying to maximize value over the long-run for shareholders.

### **Federal Tax Advantages of 2010 Calendar Year Distributions**

In 2010, the Fund passed on a portion of its income to individuals in the form of qualified dividend income or QDI. Under federal law, QDI is taxed at a maximum 15% rate instead of an individual's ordinary income tax rate. As a result of recent changes to the Internal Revenue Code, it is expected that this favorable tax rate for QDI will continue through 2012.

In calendar year 2010, approximately 52% of distributions made by the Fund was eligible for QDI treatment. For an individual in the 28% marginal tax bracket, this means that the Fund's total distributions will only be taxed at a blended 21.3% rate versus the 28% rate which would apply to distributions by a fund containing traditional corporate bonds. This tax advantage means that, all other things being equal, such an individual who held 100 shares of Common Stock of the Fund for the calendar year would have had to receive approximately \$111 in distributions from a traditional corporate bond fund to net the same after-tax amount as the \$101 distributions paid by the Fund.

For detailed information about the tax treatment of the particular distributions received from the Fund, please see the Form 1099 you receive from either the Fund or your broker.

Corporate shareholders also receive a federal tax benefit from the 20.8% of distributions that were eligible for the inter-corporate, dividends received deduction or DRD.

It is important to remember that the composition of the portfolio and the income distributions can change from one year to the next, and that the QDI or DRD portions of 2011's distributions may not be the same (or even similar) to 2010.

### **Status of the Fund's Hedging Strategy**

The Fund suspended its interest rate hedging program as the financial crisis intensified in the autumn of 2008. There were three principal reasons why we suspended the program at the time. First, the relationship between preferred securities' prices and the Fund's hedging instruments (Treasury bond futures, interest rate swaps, and options on both) was turned on its head during the financial crisis. Historically, preferred prices had tended to rise (fall) in periods of falling (rising) long-term Treasury rates, but as the financial crisis unfolded, the opposite occurred: preferred prices plunged while Treasury and swap rates fell as investors sold risky assets and raced into Treasuries. Hedging lost its effectiveness. Second, the cost of hedging rose dramatically as the yield curve steepened and options prices rose sharply. Finally, preferred securities became exceptionally cheap and were likely to offer high returns to shareholders even if Treasury yields increased moderately. Add them up, and we believed that hedging simply would not work under market conditions at the time.

Looking at the hedging strategy currently, we conclude that it remains too early to reinstate the hedging program. Although some preferred securities are starting to move in concert with the general level of long-term Treasury rates, many are not. For the preferred market as a whole, correlations between movements in prices of preferreds and the hedge instruments we use are increasing. However, they are too unstable to convince us that portfolio hedging would be reliably effective. Meanwhile, the cost of hedging is high, and preferreds continue to be attractively priced. At some point we expect that these circumstances will change. When they do, we will consider hedging again and may implement hedges prior to being able to communicate such a change to shareholders in our regular quarterly reporting.

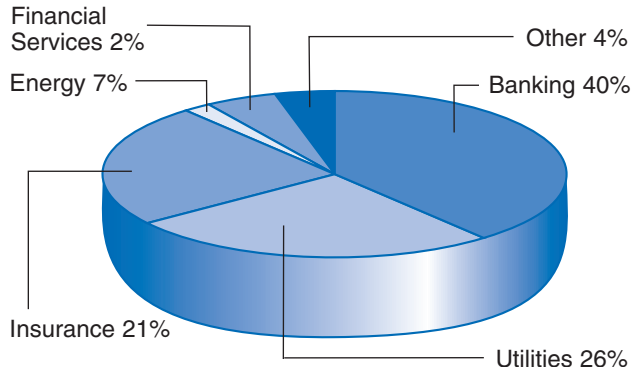
## PORTFOLIO OVERVIEW

November 30, 2010 (Unaudited)

### Fund Statistics

Net Asset Value	\$	11.86
Market Price	\$	12.03
Premium		1.43%
Yield on Market Price		8.88%
Common Stock Shares Outstanding		10,759,270

### Industry Categories



### Moody's Ratings

Moody's Rating	% of Net Assets†
A	6.1%
BBB	71.4%
BB	20.0%
Below "BB"	0.7%
Not Rated*	0.2%
Below Investment Grade**	15.9%

\* Does not include net other assets and liabilities of 1.6%

\*\* Below investment grade by both Moody's and S&P.

### Top 10 Holdings by Issuer

Top 10 Holdings by Issuer	% of Net Assets†
Banco Santander	5.1%
Capital One Financial	4.1%
PNC Financial Services	4.0%
Wells Fargo	4.0%
Liberty Mutual Group	3.9%
Metlife	3.1%
Barclays Bank Plc	2.9%
Interstate Power & Light	2.9%
Enbridge Energy Partners	2.8%
HSBC Plc	2.7%

	% of Net Assets***†
Holdings Generating Qualified Dividend Income (QDI) for Individuals	40%
Holdings Generating Income Eligible for the Corporate Dividends Received Deduction (DRD)	26%

\*\*\* This does not reflect year-end results or actual tax categorization of Fund distributions. These percentages can, and do, change, perhaps significantly, depending on market conditions. Investors should consult their tax advisor regarding their personal situation. See accompanying notes to financial statements for the tax characterization of 2010 distributions.

† Net Assets include assets attributable to the use of leverage.

**PORTFOLIO OF INVESTMENTS****November 30, 2010**

<u>Shares/\$ Par</u>		<u>Value</u>
<b>Preferred Securities — 96.0%</b>		
<b>Banking — 40.3%</b>		
\$ 2,750,000	Astoria Capital Trust I, 9.75% 11/01/29, Series B .....	\$ 2,865,063 <sup>(1)</sup>
355,000	Banco Santander, 10.50% Pfd., Series 10 .....	9,651,562 <sup>** (1)(2)</sup>
	Bank of America Corporation:	
7,500	8.625% Pfd. ....	188,025*
48,700	6.70% Pfd. ....	1,119,126 <sup>* (1)</sup>
\$ 500,000	BankAmerica Institutional, Series A, 8.07% 12/31/26, 144A**** .....	506,250
	Barclays Bank PLC:	
\$ 3,250,000	6.278% .....	2,860,000 <sup>** (1)(2)</sup>
25,000	6.625% Pfd., Series 2 .....	582,000 <sup>** (1)(2)</sup>
1,200	7.75% Pfd., Series 4 .....	30,528 <sup>** (2)</sup>
75,000	8.125% Pfd., Series 5 .....	1,935,000 <sup>** (1)(2)</sup>
58,500	BB&T Capital Trust VI, 9.60% Pfd. 08/01/64 .....	1,635,660 <sup>(1)</sup>
\$ 1,500,000	BBVA International Preferred, 5.919% .....	1,208,865 <sup>** (2)</sup>
\$ 750,000	BNP Paribas, 7.195%, 144A**** .....	748,125 <sup>** (2)</sup>
\$ 4,500,000	Capital One Capital III, 7.686% 08/15/36 .....	4,545,000 <sup>(1)</sup>
\$ 500,000	Capital One Capital V, 10.25% 08/15/39 .....	531,875
\$ 2,500,000	Capital One Capital VI, 8.875% 05/15/40 .....	2,631,250 <sup>(1)</sup>
62,300	Citigroup Capital XIII, 7.875% Pfd. 10/30/40 .....	1,645,499
\$ 5,210,000	Colonial BancGroup, 7.114%, 144A**** .....	131,813 <sup>††</sup>
9,000	FBOP Corporation, Adj. Rate Pfd., 144A**** .....	39,816 <sup>* † (3)</sup>
\$ 750,000	Fifth Third Capital Trust IV, 6.50% 04/15/37 .....	703,125
15,000	Fifth Third Capital Trust V, 7.25% Pfd. 08/15/67 .....	373,650
130,000	Fifth Third Capital Trust VI, 7.25% Pfd. 11/15/67 .....	3,254,225 <sup>(1)</sup>
14,500	Fifth Third Capital Trust VII, 8.875% Pfd. 05/15/68 .....	375,188
1,250	First Republic Preferred Capital Corporation, 10.50% Pfd., 144A**** .....	1,291,250 <sup>(1)</sup>
22,500	First Republic Preferred Capital Corporation II, 8.75% Pfd., Series B, 144A**** ..	574,454 <sup>(1)</sup>
3,750	First Tennessee Bank, Adj. Rate Pfd., 144A**** .....	2,341,406 <sup>* (1)</sup>
\$ 600,000	First Tennessee Capital I, 8.07% 01/06/27, Series A .....	566,732
\$ 500,000	First Tennessee Capital II, 6.30% 04/15/34, Series B .....	375,813
\$ 1,500,000	First Union Capital II, 7.95% 11/15/29 .....	1,635,079 <sup>(1)</sup>
\$ 1,000,000	First Union Institutional Capital I, 8.04% 12/01/26 .....	1,024,800 <sup>(1)</sup>
\$ 500,000	Fleet Capital Trust II, 7.92% 12/11/26 .....	505,000
	Goldman Sachs:	
\$ 500,000	Capital I, 6.345% 02/15/34 .....	467,780 <sup>(1)</sup>
\$ 1,938,000	Capital II, 5.793% .....	1,647,300 <sup>(1)</sup>
2,800	STRIPES Custodial Receipts, Pvt. ....	1,890,000 <sup>* (3)</sup>
113,400	HSBC Holdings PLC, 8.00% Pfd., Series 2 .....	3,065,349 <sup>** (1)(2)</sup>

The accompanying notes are an integral part of the financial statements.

**PORTFOLIO OF INVESTMENTS (Continued)**

November 30, 2010

<u>Shares/\$ Par</u>		<u>Value</u>
<b>Preferred Securities — (continued)</b>		
<b>Banking — (continued)</b>		
\$ 500,000	HSBC USA Capital Trust II, 8.38% 05/15/27, 144A****	\$ 510,873
	HSBC USA, Inc.:	
42,000	6.50% Pfd., Series H	1,043,440 <sup>(1)</sup>
4,400	\$2.8575 Pfd.	209,688 <sup>(1)</sup>
\$ 1,175,000	JPMorgan Chase Capital XVIII, 6.95% 08/17/36, Series R	1,182,025
15,000	Keycorp Capital VIII, 7.00% Pfd. 06/15/66	371,723 <sup>(1)</sup>
72,000	Keycorp Capital IX, 6.75% Pfd. 12/15/66	1,792,188
27,600	Keycorp Capital X, 8.00% Pfd. 03/15/68	710,700 <sup>(1)</sup>
\$ 550,000	Lloyds Banking Group PLC, 6.657%, 144A****	371,250 <sup>**</sup> (2)†
3,000	National City Capital Trust II, 6.625% Pfd. 11/15/36	75,038
\$ 860,000	NB Capital Trust IV, 8.25% 04/15/27	872,900 <sup>(1)</sup>
200,000	PNC Financial Services, 9.875% Pfd., Series L	5,581,260 <sup>(1)</sup>
\$ 1,750,000	PNC Preferred Funding Trust III, 8.70%, 144A****	1,883,905 <sup>(1)</sup>
1,750	Sovereign REIT, 12.00% Pfd., Series A, 144A****	1,999,375
\$ 2,400,000	Wachovia Capital Trust III, 5.80%	2,040,000 <sup>(1)</sup>
\$ 1,200,000	Wachovia Capital Trust V, 7.965% 06/01/27, 144A****	1,211,636
\$ 1,000,000	Washington Mutual, 9.75%, 144A****	35,000††
\$ 1,600,000	Webster Capital Trust IV, 7.65% 06/15/37	1,390,379 <sup>(1)</sup>
15,000	Wells Fargo & Company, 8.00% Pfd., Series J	400,950*
\$ 1,000,000	Wells Fargo Capital XV, 9.75%	1,118,750 <sup>(1)</sup>
		<u>75,747,688</u>
<b>Financial Services — 1.8%</b>		
33,000	Heller Financial, Inc., 6.687% Pfd., Series C	3,177,283 <sup>(1)</sup>
10,300	HSBC Finance Corporation, 6.36% Pfd.	241,973*
	Lehman Brothers Holdings, Inc.:	
15,000	5.67% Pfd., Series D	4,125*††
19,500	5.94% Pfd., Series C	5,265*††
25,000	6.50% Pfd., Series F	1,812*††
27,500	7.95% Pfd.	440*††
		<u>3,430,898</u>
<b>Insurance — 19.0%</b>		
\$ 975,000	Ace Capital Trust II, 9.70% 04/01/30	1,190,010 <sup>(1)(2)</sup>
\$ 250,000	AON Corporation, 8.205% 01/01/27	265,080
14,300	Arch Capital Group Ltd., 8.00% Pfd., Series A	364,650 <sup>**</sup> (1)(2)

The accompanying notes are an integral part of the financial statements.

**PORTFOLIO OF INVESTMENTS (Continued)**

November 30, 2010

<u>Shares/\$ Par</u>		<u>Value</u>
<b>Preferred Securities — (continued)</b>		
<b>Insurance — (continued)</b>		
	AXA SA:	
\$ 1,750,000	6.379%, 144A****	\$ 1,627,500** <sup>(1)(2)</sup>
\$ 2,250,000	6.463%, 144A****	2,070,000** <sup>(1)(2)</sup>
35,900	Axis Capital Holdings, 7.50% Pfd., Series B	3,316,262 <sup>(1)(2)</sup>
90,600	Delphi Financial Group, 7.376% Pfd. 05/15/37	2,120,611 <sup>(1)</sup>
\$ 4,000,000	Everest Re Holdings, 6.60% 05/15/37	3,800,000 <sup>(1)</sup>
\$ 4,100,000	Liberty Mutual Group, 10.75% 06/15/58, 144A****	5,043,000 <sup>(1)</sup>
\$ 2,100,000	MetLife Capital Trust X, 9.25% 04/08/38, 144A****	2,493,750 <sup>(1)</sup>
\$ 2,400,000	MetLife, Inc., 10.75% 08/01/39	3,242,345 <sup>(1)</sup>
	Principal Financial Group:	
16,000	5.563% Pfd., Series A	1,469,000* <sup>(1)</sup>
62,500	6.518% Pfd., Series B	1,558,594* <sup>(1)</sup>
60,000	Renaissancere Holdings Ltd., 6.08% Pfd., Series C	1,372,800** <sup>(1)(2)</sup>
119,500	Scottish Re Group Ltd., 7.25% Pfd.	1,023,219** <sup>(2)†</sup>
\$ 1,300,000	Stancorp Financial Group, 6.90% 06/01/67	1,249,598 <sup>(1)</sup>
\$ 750,000	USF&G Capital, 8.312% 07/01/46, 144A****	819,303 <sup>(1)</sup>
\$ 2,000,000	XL Capital Ltd., 6.50%, Series E	1,725,000 <sup>(1)(2)</sup>
\$ 1,000,000	ZFS Finance USA Trust V, 6.50% 05/09/37, 144A****	977,500
		<u>35,728,222</u>
<b>Utilities — 26.0%</b>		
10,000	Baltimore Gas & Electric Company, 6.70% Pfd., Series 1993	996,250* <sup>(1)</sup>
20,600	Calenergy Capital Trust III, 6.50% Pfd. 09/01/27	1,022,790
\$ 3,458,000	COMED Financing III, 6.35% 03/15/33	3,003,626 <sup>(1)</sup>
\$ 250,000	Dominion Resources Capital Trust I, 7.83% 12/01/27	256,928
	Dominion Resources, Inc.:	
\$ 3,500,000	7.50% 06/30/66	3,644,123 <sup>(1)</sup>
22,500	8.375% Pfd. 06/15/64, Series A	659,250 <sup>(1)</sup>
40,000	Entergy Arkansas, Inc., 6.45% Pfd.	986,252* <sup>(1)</sup>
20,000	Entergy Louisiana, Inc., 6.95% Pfd.	1,958,126*
\$ 2,000,000	FPL Group Capital, Inc., 6.65% 06/15/67	1,977,578 <sup>(1)</sup>
	Georgia Power Company:	
4,719	6.125% Pfd.	121,809*
25,000	6.50% Pfd., Series 2007A	2,664,845* <sup>(1)</sup>
3,000	Gulf Power Company, 6.45% Pfd., Series 2007A	312,909* <sup>(1)</sup>
32,650	Indianapolis Power & Light Company, 5.65% Pfd.	3,066,041*

The accompanying notes are an integral part of the financial statements.

**PORTFOLIO OF INVESTMENTS (Continued)**

November 30, 2010

<u>Shares/\$ Par</u>		<u>Value</u>
<b>Preferred Securities — (continued)</b>		
<b>Utilities — (continued)</b>		
185,596	Interstate Power & Light Company, 8.375% Pfd., Series B .....	\$ 5,380,892 <sup>*(1)</sup>
7,146	MDU Resources Group, 4.50% Pfd. 07/08/10 .....	582,399*
22,430	Pacific Enterprises, \$4.50 Pfd. ....	1,894,635 <sup>*(1)</sup>
\$ 500,000	PECO Energy Capital Trust III, 7.38% 04/06/28, Series D .....	485,726 <sup>(1)</sup>
\$ 4,400,000	Puget Sound Energy, Inc., 6.974% 06/01/67 .....	4,319,269 <sup>(1)</sup>
55,500	Scana Corporation, 7.70% Pfd. 01/30/65 .....	1,531,800 <sup>(1)</sup>
	Southern California Edison:	
32,100	6.00% Pfd., Series C .....	3,116,711 <sup>*(1)</sup>
17,500	6.125% Pfd. ....	1,743,438*
\$ 1,985,000	Southern Union Company, 7.20% 11/01/66 .....	1,826,200 <sup>(1)</sup>
\$ 750,000	TXU Electric Capital V, 8.175% 01/30/37 .....	200,625 <sup>(3)</sup>
\$ 3,500,000	Wisconsin Energy Corporation, 6.25% 05/15/67 .....	3,434,480 <sup>(1)</sup>
\$ 3,250,000	WPS Resources Corporation, 6.11% 12/01/66 .....	3,156,387 <sup>(1)</sup>
6,750	Xcel Energy, Inc., \$4.08 Pfd., Series B .....	526,365*
		<u>48,869,454</u>
	<b>Energy — 7.0%</b>	
\$ 5,000,000	Enbridge Energy Partners LP, 8.05% 10/01/37 .....	5,252,740 <sup>(1)</sup>
	Enterprise Products Partners:	
\$ 750,000	7.00% 06/01/67 .....	738,478
\$ 3,250,000	8.375% 08/01/66, Series A .....	3,457,015 <sup>(1)</sup>
3,500	Kinder Morgan GP, Inc., 8.33% Pfd., 144A**** .....	3,647,875*
		<u>13,096,108</u>
	<b>Real Estate Investment Trust (REIT) — 0.2%</b>	
12,500	PS Business Parks, Inc., 6.70% Pfd., Series P .....	307,531
		<u>307,531</u>
	<b>Miscellaneous Industries — 1.7%</b>	
40,000	Ocean Spray Cranberries, Inc., 6.25% Pfd., 144A**** .....	3,305,000 <sup>*(1)</sup>
		<u>3,305,000</u>
	<b>Total Preferred Securities</b>	
	(Cost \$175,334,896) .....	<u>180,484,901</u>

The accompanying notes are an integral part of the financial statements.

Flaherty & Crumrine Preferred Income Fund Incorporated  
**PORTFOLIO OF INVESTMENTS (Continued)**  
**November 30, 2010**

<u>Shares/\$ Par</u>	<u>Value</u>
<b>Corporate Debt Securities — 2.5%</b>	
<b>Financial Services — 0.2%</b>	
16,800	Goldman Sachs Group, 6.125% 11/01/60 . . . . . \$ 401,626
	401,626
<b>Insurance — 2.3%</b>	
\$ 2,500,000	Liberty Mutual Insurance, 7.697% 10/15/97, 144A**** . . . . . 2,270,282 <sup>(1)</sup>
\$ 2,000,000	UnumProvident Corporation, 7.25% 03/15/28 . . . . . 2,074,060 <sup>(1)</sup>
	4,344,342
<b>Total Corporate Debt Securities</b>	
(Cost \$3,835,879) . . . . .	
	4,745,968
<b>Common Stock — 0.1%</b>	
<b>Banking — 0.1%</b>	
3,620	CIT Group, Inc. . . . . 142,845 <sup>†</sup>
<b>Total Common Stock</b>	
(Cost \$330,325) . . . . .	
	142,845
<b>Money Market Fund — 0.4%</b>	
776,629	BlackRock Liquidity Funds, T-Fund . . . . . 776,629
<b>Total Money Market Fund</b>	
(Cost \$776,629) . . . . .	
	776,629
<b>Total Investments</b> (Cost \$180,277,729 <sup>***</sup> ) . . . . . 99.0%	
<b>Other Assets And Liabilities</b> (Net) . . . . . 1.0%	
	186,150,343
	1,910,780
<b>Net Assets before loan</b> . . . . . 100.0% <sup>‡</sup>	
	\$ 188,061,123
<b>Loan Principal Balance</b> . . . . .	
	(60,500,000)
<b>Total Net Assets Available To Common Stock</b> . . . . .	
	\$ 127,561,123

The accompanying notes are an integral part of the financial statements.

## PORTFOLIO OF INVESTMENTS (Continued)

November 30, 2010

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- \* Securities eligible for the Dividends Received Deduction and distributing Qualified Dividend Income.
  - \*\* Securities distributing Qualified Dividend Income only.
  - \*\*\* Aggregate cost of securities held.
  - \*\*\*\* 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. At November 30, 2010, these securities amounted to \$33,899,363 or 18.0% of net assets before loan.
  - (1) All or a portion of this security has been pledged as collateral for the Fund's loan. The total value of such securities was \$131,311,392 at November 30, 2010.
  - (2) Foreign Issuer.
  - (3) Illiquid.
  - † Non-income producing.
  - †† The issuer has filed for bankruptcy protection. As a result, the Fund may not be able to recover the principal invested and also does not expect to receive income on this security going forward.
  - ‡ The percentage shown for each investment category is the total value of that category as a percentage of net assets before the loan.

### ABBREVIATIONS:

- Pfd.** — Preferred Securities
- Pvt.** — Private Placement Securities
- REIT** — Real Estate Investment Trust
- STRIPES** — Structured Residual Interest Preferred Enhanced Securities



**STATEMENT OF ASSETS AND LIABILITIES****November 30, 2010****ASSETS:**

Investments, at value (Cost \$180,277,729) . . . . .	\$ 186,150,343
Receivable for investments sold . . . . .	7,435
Dividends and interest receivable . . . . .	2,419,016
Prepaid expenses. . . . .	<u>59,238</u>
Total Assets. . . . .	188,636,032

**LIABILITIES:**

Loan Payable . . . . .	\$60,500,000
Payable for investments purchased . . . . .	265,400
Dividends payable to Common Stock Shareholders . . . . .	100,989
Investment advisory fee payable . . . . .	88,043
Administration, Transfer Agent and Custodian fees payable . . . . .	28,359
Professional fees payable . . . . .	62,481
Directors' fees payable . . . . .	1,282
Accrued expenses and other payables . . . . .	<u>28,355</u>
Total Liabilities. . . . .	<u>61,074,909</u>

**NET ASSETS AVAILABLE TO COMMON STOCK . . . . .** \$ 127,561,123

**NET ASSETS AVAILABLE TO COMMON STOCK** consist of:

Undistributed net investment income . . . . .	\$ 621,099
Accumulated net realized loss on investments sold . . . . .	(32,176,053)
Unrealized appreciation of investments . . . . .	5,872,614
Par value of Common Stock . . . . .	107,593
Paid-in capital in excess of par value of Common Stock. . . . .	<u>153,135,870</u>
Total Net Assets Available to Common Stock. . . . .	<u><u>\$ 127,561,123</u></u>

**NET ASSET VALUE PER SHARE OF COMMON STOCK:**

Common Stock (10,759,270 shares outstanding) . . . . .	<u><u>\$ 11.86</u></u>
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## STATEMENT OF OPERATIONS

For the Year Ended November 30, 2010

### INVESTMENT INCOME:

Dividends† . . . . .	\$ 6,758,278
Interest . . . . .	<u>7,463,708</u>
Total Investment Income . . . . .	14,221,986

### EXPENSES:

Investment advisory fees . . . . .	\$1,007,775
Administrator's fees . . . . .	183,630
Professional fees . . . . .	116,118
Insurance expenses . . . . .	112,051
Transfer Agent fees . . . . .	60,896
Directors' fees . . . . .	71,898
Custodian fees . . . . .	24,816
Compliance fees . . . . .	37,697
Interest expense . . . . .	854,382
Other . . . . .	<u>246,900</u>
Total Expenses . . . . .	<u>2,716,163</u>

**NET INVESTMENT INCOME** . . . . . 11,505,823

### REALIZED AND UNREALIZED GAIN/(LOSS) ON INVESTMENTS

Net realized gain on investments sold during the year . . . . .	4,930,971
Change in net unrealized appreciation/depreciation of investments . . . . .	<u>15,769,549</u>

**NET REALIZED AND UNREALIZED GAIN ON INVESTMENTS** . . . . . 20,700,520

### DISTRIBUTIONS TO AUCTION PREFERRED STOCK SHAREHOLDERS:

From net investment income (including changes in accumulated undeclared distributions) . . . . .	<u>(70,977)</u>
--	-----------------

**NET INCREASE IN NET ASSETS TO COMMON STOCK RESULTING FROM OPERATIONS** . . . . . \$ 32,135,366

† For Federal income tax purposes, a significant portion of this amount may not qualify for the inter-corporate dividends received deduction ("DRD") or as qualified dividend income ("QDI") for individuals.

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**STATEMENTS OF CHANGES IN NET ASSETS AVAILABLE TO COMMON STOCK**


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	Year Ended November 30, 2010	Year Ended November 30, 2009
<b>OPERATIONS:</b>		
Net investment income . . . . .	\$ 11,505,823	\$ 9,734,389
Net realized gain/(loss) on investments sold during the year . . . . .	4,930,971	(15,921,276)
Change in net unrealized appreciation/depreciation of investments. . . . .	15,769,549	56,189,433
Distributions to APS* Shareholders from net investment income, including changes in accumulated undeclared distributions . . . . .	<u>(70,977)</u>	<u>(1,041,660)</u>
<b>Net increase in net assets resulting from operations . . . . .</b>	<b>32,135,366</b>	<b>48,960,886</b>
<b>DISTRIBUTIONS:</b>		
Dividends paid from net investment income to Common Stock Shareholders <sup>(1)</sup> . . . . .	<u>(10,325,246)</u>	<u>(8,040,825)</u>
<b>Total Distributions to Common Stock Shareholders . . . . .</b>	<b>(10,325,246)</b>	<b>(8,040,825)</b>
<b>FUND SHARE TRANSACTIONS:</b>		
Increase from shares issued under the Dividend Reinvestment and Cash Purchase Plan. . . . .	<u>986,882</u>	<u>566,685</u>
<b>Net increase in net assets available to Common Stock resulting from Fund share transactions . . . . .</b>	<b>986,882</b>	<b>566,685</b>
<b>NET INCREASE IN NET ASSETS AVAILABLE TO COMMON STOCK FOR THE YEAR . . . . .</b>	<b><u>\$ 22,797,002</u></b>	<b><u>\$ 41,486,746</u></b>
<hr/>		
<b>NET ASSETS AVAILABLE TO COMMON STOCK:</b>		
Beginning of year . . . . .	\$ 104,764,121	\$ 63,277,375
Net increase in net assets during the year . . . . .	<u>22,797,002</u>	<u>41,486,746</u>
End of year (including undistributed net investment income of \$621,099 and \$31,856, respectively) . . . . .	<u>\$127,561,123</u>	<u>\$104,764,121</u>

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\* Auction Preferred Stock.

<sup>(1)</sup> May include income earned, but not paid out, in prior fiscal year.

## STATEMENT OF CASH FLOWS

For the Year Ended November 30, 2010

### INCREASE/(DECREASE) IN CASH

#### CASH FLOWS FROM OPERATING ACTIVITIES:

Net increase in net assets resulting from operations. . . . . \$ 32,135,366

#### ADJUSTMENTS TO RECONCILE NET INCREASE IN NET ASSETS RESULTING FROM OPERATIONS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:

Purchase of investment securities . . . . .	(73,762,167)
Proceeds from disposition of investment securities . . . . .	63,747,067
Sale of short-term investment securities, net. . . . .	(250,281)
Cash received from litigation claim . . . . .	36,991
Increase in dividends and interest receivable . . . . .	(360,510)
Increase in receivable for investments sold. . . . .	(7,435)
Decrease in prepaid expenses. . . . .	165,450
Net amortization/(accretion) of premium/(discount) . . . . .	(553,770)
Increase in payable for investments purchased. . . . .	265,400
Increase in payables to related parties . . . . .	13,616
Increase in accrued expenses and other liabilities . . . . .	2,163
Change in net unrealized appreciation/depreciation on securities. . . . .	(15,769,549)
Net realized gain from investments sold . . . . .	<u>(4,930,971)</u>
Net cash provided by operating activities. . . . .	<u>731,370</u>

#### CASH FLOWS FROM FINANCING ACTIVITIES:

Proceeds from loan . . . . .	8,700,000
Decrease in payable for APS . . . . .	(132,290)
Dividends paid (net of reinvestment of dividends and change in dividends payable) to common stock shareholders from net investment income . . . . .	<u>(9,299,080)</u>
Net cash used by financing activities . . . . .	<u>(731,370)</u>
Net increase/(decrease) in cash. . . . .	—

#### CASH:

Beginning of the year . . . . .	—
End of the year. . . . .	<u><u>\$ —</u></u>

#### SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

Interest paid during the year . . . . .	\$ 857,675
Reinvestment of dividends . . . . .	986,882
Increase in dividends payable to common stock shareholders . . . . .	39,284

**FINANCIAL HIGHLIGHTS****For a Common Stock share outstanding throughout each year.**

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.

	<b>Year Ended November 30,</b>				
	<b>2010</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>
<b>PER SHARE OPERATING PERFORMANCE:</b>					
Net asset value, beginning of year .....	\$ 9.82	\$ 5.98	\$ 12.85	\$ 15.80	\$ 15.26
<b>INVESTMENT OPERATIONS:</b>					
Net investment income .....	1.07	0.92	1.27	1.35	1.29
Net realized and unrealized gain/(loss) on investments .....	1.94	3.78	(6.80)	(2.90)	0.62
<b>DISTRIBUTIONS TO APS* SHAREHOLDERS:</b>					
From net investment income .....	(0.01)	(0.10)	(0.42)	(0.37)	(0.32)
Total from investment operations .....	3.00	4.60	(5.95)	(1.92)	1.59
<b>DISTRIBUTIONS TO COMMON STOCK SHAREHOLDERS:</b>					
From net investment income .....	(0.96)	(0.76)	(0.87)	(1.03)	(1.05)
From return of capital .....	—	—	(0.05)	—	—
Total distributions to Common Stock Shareholders .....	(0.96)	(0.76)	(0.92)	(1.03)	(1.05)
Net asset value, end of year .....	<u>\$ 11.86</u>	<u>\$ 9.82</u>	<u>\$ 5.98</u>	<u>\$ 12.85</u>	<u>\$ 15.80</u>
Market value, end of year .....	\$ 12.03	\$ 9.12	\$ 5.67	\$ 12.41	\$ 16.98
Total investment return based on net asset value** .....	31.52%	82.53%	(48.39%)	(12.90%)	10.74%
Total investment return based on market value** .....	43.65%	78.78%	(49.34%)	(21.73%)	10.47%
<b>RATIOS TO AVERAGE NET ASSETS AVAILABLE TO COMMON STOCK SHAREHOLDERS:</b>					
Total net assets, end of year (in 000's) .....	\$127,561	\$104,764	\$ 63,277	\$135,555	\$165,475
Operating expenses including interest expense <sup>(1)</sup> .....	2.29%	2.44%	—	—	—
Operating expenses excluding interest expense .....	1.57%	2.04%	1.99%	1.49%	1.49%
Net investment income † .....	9.72%	12.55%	—	—	—
Net investment income, including payments to APS Shareholders † .....	9.66%	11.21%	8.38%	6.57%	6.39%
<b>SUPPLEMENTAL DATA: ††</b>					
Portfolio turnover rate .....	37%	56%	67%	59%	71%
Net assets before loan, end of year (in 000's) .....	\$188,061	\$156,564	\$118,077	\$215,555	\$245,475
Ratio of operating expenses including interest expense <sup>(1)(2)</sup> to net assets before loan and APS .....	1.54%	1.50%	—	—	—
Ratio of operating expenses excluding interest expense <sup>(2)</sup> to net assets before loan and APS .....	1.05%	1.25%	1.15%	0.99%	0.99%

\* Auction Preferred Stock.

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

† The net investment income ratios reflect income net of operating expenses, including interest expense.

†† Information presented under heading Supplemental Data includes APS and loan principal balance.

<sup>(1)</sup> See Note 8.

<sup>(2)</sup> Does not include distributions to APS shareholders.

The accompanying notes are an integral part of the financial statements.

**FINANCIAL HIGHLIGHTS (Continued)**

**Per Share of Common Stock**

	Total Dividends Paid	Net Asset Value	NYSE Closing Price	Dividend Reinvestment Price <sup>(1)</sup>
December 31, 2009 .....	\$0.0720	\$10.31	\$10.47	\$10.31
January 29, 2010 .....	0.0720	10.52	10.59	10.52
February 26, 2010 .....	0.0720	10.67	11.37	10.80
March 31, 2010 .....	0.0720	11.08	11.32	11.08
April 30, 2010 .....	0.0720	11.24	11.93	11.33
May 28, 2010 .....	0.0825	10.48	10.67	10.48
June 30, 2010 .....	0.0825	10.65	11.30	10.74
July 30, 2010 .....	0.0825	11.15	12.33	11.71
August 31, 2010 .....	0.0890	11.49	12.37	11.75
September 30, 2010 .....	0.0890	11.82	13.18	12.52
October 29, 2010 .....	0.0890	12.00	12.63	12.00
November 30, 2010 .....	0.0890	11.86	12.03	11.86

<sup>(1)</sup> 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 reinvestment 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.

**FINANCIAL HIGHLIGHTS (Continued)****Senior Securities**

<u>Date</u>	<u>Total APS* Shares Outstanding (1)</u>	<u>Asset Coverage Per APS Share (2)</u>	<u>Involuntary Liquidation Preference Per APS Share (3)</u>	<u>Total Debt Outstanding End of Period (000s) (4)</u>	<u>Asset Coverage Per \$1,000 of Debt (5)</u>
11/30/10	—	N/A	N/A	\$60,500	\$3,108
11/30/09	—	N/A	N/A	51,800	3,022
11/30/08	548	\$216,717	\$100,000	N/A	N/A
11/30/07	800	270,586	100,000	N/A	N/A
11/30/06	800	307,433	100,000	N/A	N/A

<sup>(1)</sup> See note 7.

<sup>(2)</sup> Calculated by subtracting the Fund's total liabilities (excluding the APS and accumulated undeclared distributions to APS) from the Fund's total assets and dividing that amount by the number of APS shares outstanding.

<sup>(3)</sup> Excludes accumulated undeclared dividends.

<sup>(4)</sup> See note 8.

<sup>(5)</sup> Calculated by subtracting the Fund's total liabilities (excluding the loan) from the Fund's total assets and dividing that amount by the loan outstanding in 000's.

\* Auction Preferred Stock.

## **NOTES TO FINANCIAL STATEMENTS**

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### **1. Organization**

Flaherty & Crumrine Preferred Income Fund Incorporated (the “Fund”) was incorporated as a Maryland corporation on September 28, 1990, and commenced operations on January 31, 1991 as a diversified, closed-end management investment company under the Investment Company Act of 1940, as amended (the “1940 Act”). The Fund’s investment objective is to provide its common shareholders with high current income consistent with the preservation of capital.

### **2. Significant Accounting Policies**

The following is a summary of significant accounting policies consistently followed by the Fund in the preparation of its financial statements. The preparation of the financial statements is in conformity with U.S. generally accepted accounting principles (“US GAAP”) and requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities in the financial statements and the reported amounts of increases and decreases in net assets from operations during the reporting period. Actual results could differ from those estimates.

*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 in accordance with the policies and procedures approved by the Board of Directors of the Fund. It is determined by dividing the value of the Fund’s net assets available to Common Stock by the number of shares of Common Stock outstanding. The value of the Fund’s net assets available to Common Stock is deemed to equal the value of the Fund’s total assets less (i) the Fund’s liabilities and (ii) the aggregate liquidation value of any outstanding preferred stock.

The Fund’s preferred and debt securities are valued on the basis of current market quotations provided by independent pricing services or dealers approved by the Board of Directors of the Fund. Each quotation is based on the mean of the bid and asked prices of a security. In determining the value of a particular preferred or debt security, a pricing service or dealer may use information with respect to transactions in such investments, quotations, market transactions in comparable investments, various relationships observed in the market between investments, and/or calculated yield measures based on valuation technology commonly employed in the market for such investments. Common stocks that are traded on stock exchanges are valued at the last sale price or official close price on the exchange, as of the close of business on the day the securities are being valued or, lacking any sales, at the last available mean price. Futures contracts and option contracts on futures contracts are valued on the basis of the settlement price for such contracts on the primary exchange on which they trade. Investments in over-the-counter derivative instruments, such as interest rate swaps and options thereon (“swaptions”), are valued using prices supplied by a pricing service, or if such prices are unavailable, prices provided by a single broker or dealer that is not the counterparty or, if no such prices are available, at a price at which the counterparty to the contract would repurchase the instrument or terminate the contract. 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.



**NOTES TO FINANCIAL STATEMENTS (Continued)**

Investments in money market instruments and all debt and preferred securities which mature in 60 days or less are valued at amortized cost. Investments in money market funds are valued at the net asset value of such funds.

*Fair Value Measurement:* The inputs and valuation techniques used to measure fair value of the Fund's investments are summarized into three levels as described in the hierarchy below:

- Level 1 – quoted prices in active markets for identical securities
- Level 2 – other significant observable inputs (including quoted prices for similar securities, interest rates, prepayment speeds, credit risk, etc.)
- Level 3 – significant unobservable inputs (including the Fund's own assumptions in determining the fair value of investments)

The inputs or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities. Transfers in and out of levels are recognized at market value at the end of the period. A summary of the inputs used to value the Fund's investments as of November 30, 2010 is as follows:

	<u>Total Value at November 30, 2010</u>	<u>Level 1 Quoted Price</u>	<u>Level 2 Significant Observable Inputs</u>	<u>Level 3 Significant Unobservable Inputs</u>
Preferred Securities				
Banking	\$75,747,688	\$49,998,249	\$25,709,623	\$39,816
Financial Services	3,430,898	241,973	3,188,925	—
Insurance	35,728,222	12,175,969	23,552,253	—
Utilities	48,869,454	11,337,874	37,531,580	—
Energy	13,096,108	—	13,096,108	—
Real Estate Investment Trust (REIT)	307,531	307,531	—	—
Miscellaneous Industries	3,305,000	—	3,305,000	—
Corporate Debt Securities	4,745,968	401,626	4,344,342	—
Common Stock				
Banking	142,845	142,845	—	—
Money Market Fund	<u>776,629</u>	<u>776,629</u>	<u>—</u>	<u>—</u>
Total Investments	<u>\$186,150,343</u>	<u>\$75,382,696</u>	<u>\$110,727,831</u>	<u>\$39,816</u>

The Fund did not have any significant transfers in and out of Level 1 and Level 2 during the period.

The Fund's investments in Level 2 and Level 3 are based primarily on market information, where available. This includes, but is not limited to, prices provided by third-party providers, observable trading activity (including the recency, depth, and consistency of such information with quoted levels), and the depth and consistency of broker-quoted prices. In the event market information is not directly available, comparable information may be observed for securities that are similar in many respects to those being valued. The Fund

**NOTES TO FINANCIAL STATEMENTS (Continued)**

may employ an income approach for certain securities that also takes into account credit risk, interest rate risk, and potential recovery prospects.

The following is a reconciliation of Level 3 investments for which significant unobservable inputs were used to determine fair value:

	<b>Total Investments</b>	<b>Preferred Securities Banking</b>
<b>Balance as of 11/30/09</b> . . . . .	\$ 49,500	\$ 49,500
Accrued discounts/premiums. . . . .	—	—
Realized gain/(loss). . . . .	—	—
Change in unrealized appreciation/(depreciation). . . . .	(9,684)	(9,684)
Net purchases/(sales) . . . . .	—	—
Transfers in and/or out of Level 3 . . . . .	—	—
<b>Balance as of 11/30/10</b> . . . . .	<b>\$ 39,816</b>	<b>\$ 39,816</b>

As of November 30, 2010, total change in unrealized gain/(loss) on Level 3 securities still held at period-end and included in the change in net assets was \$(9,684). Total unrealized gain/(loss) for all securities (including Level 1 and Level 2) can be found on the accompanying Statement of Operations.

*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 specific identified cost basis. Dividend income is recorded on ex-dividend dates. Interest income is recorded on the accrual basis. The Fund also amortizes premiums and accretes discounts on fixed income securities using the effective yield method.

*Options:* Purchases of options are recorded as an investment, the value of which is marked-to-market at each valuation date. 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.

When the Fund writes an option, an amount equal to the premium received by the Fund is recorded as a liability, the value of which is marked-to-market at each valuation date. When a written option expires, the Fund realizes a gain equal to the amount of the premium originally received. When the Fund enters into a closing purchase transaction, the Fund realizes a gain (or loss if the cost of the closing purchase transaction exceeds the premium received when the option was written) without regard to any unrealized gain or loss on the underlying security, and the liability related to such option is eliminated. When a call option is exercised, the Fund realizes a gain or loss from the sale of the underlying security and the proceeds from such sale are increased by the amount of the premium originally received. When a put option is exercised, the amount of the premium originally received will reduce the cost of the security which the Fund purchased upon exercise.

*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

**NOTES TO FINANCIAL STATEMENTS (Continued)**

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.

*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.

Management has analyzed the Fund's tax positions taken on Federal income tax returns for all open tax years (November 30, 2010, 2009, 2008 and 2007), and has concluded that no provision for federal income tax is required in the Fund's financial statements. The Fund's major tax jurisdictions are federal and California. The Fund's federal and state income and federal excise tax returns for tax years for which the applicable statutes of limitations have not expired are subject to examination by the Internal Revenue Service and state departments of revenue.

*Dividends and distributions to shareholders:* The Fund expects to declare dividends on a monthly basis to shareholders of Common Stock ("Shareholders"). 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 capital gains may be used by the Fund's Shareholders as a credit against their own tax liabilities. The Fund may pay distributions in excess of the Fund's net investment company taxable income and this excess would be a tax-free return of capital distributed from the Fund's assets.

Income and capital gain distributions are determined and characterized in accordance with income tax regulations which may differ from US GAAP. 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 proportionate allocation of income and gains to all classes of shareholders.

Distributions from net realized gains for book purposes may include short-term capital gains, which are included as ordinary income for tax purposes, and may exclude amortization of premium on certain fixed income securities, which are not reflected in ordinary income for tax purposes. The tax character of distributions paid, including changes in accumulated undeclared distributions to APS shareholders, during 2010 and 2009 was as follows:

	<u>Distributions paid in fiscal year 2010</u>		<u>Distributions paid in fiscal year 2009</u>	
	<u>Ordinary Income</u>	<u>Long-Term Capital Gains</u>	<u>Ordinary Income</u>	<u>Long-Term Capital Gains</u>
Common	\$10,325,246	\$0	\$8,040,825	\$0
Preferred	\$70,977	\$0	\$1,041,660	\$0

## NOTES TO FINANCIAL STATEMENTS (Continued)

As of November 30, 2010, the components of distributable earnings (i.e., ordinary income and capital gain/loss) available to Common Stock Shareholders, on a tax basis, were as follows:

<u>Capital (Loss) Carryforward</u>	<u>Undistributed Ordinary Income</u>	<u>Undistributed Long-Term Gain</u>	<u>Net Unrealized Appreciation/(Depreciation)</u>
\$(32,375,398)	\$974,075	\$0	\$6,071,959

The composition of the Fund's \$32,375,398 accumulated realized capital losses was \$16,447,249 and \$15,928,149 incurred in 2008 and 2009, respectively. These losses may be carried forward and offset against any future capital gains through 2016 and 2017, respectively. During the year ended November 30, 2010, the Fund utilized \$778,250, \$2,761,487 and \$1,738,373 of capital losses expiring in 2012, 2015 and 2016, respectively.

*Reclassification of accounts:* During the year ended November 30, 2010, reclassifications were made in the Fund's capital accounts to report these balances on a tax basis, excluding temporary differences, as of November 30, 2010. Additional adjustments may be required in subsequent reporting periods. These reclassifications have no impact on the net asset value of the Fund. The calculation of net investment income per share in the financial highlights excludes these adjustments. Below are the reclassifications:

<u>Paid-in Capital</u>	<u>Undistributed Net Investment Income</u>	<u>Accumulated Net Realized Gain on Investments</u>
\$11,100	\$(520,357)	\$509,257

*Excise tax:* 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. The Fund is subject to a payment of an estimated \$20,000 of Federal excise taxes attributable to calendar year 2010. The Fund paid \$13,975 of Federal excise taxes attributable to calendar year 2009 in March 2010.

*Additional Accounting Standards:* In January 2010, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2010-06, "Improving Disclosures about Fair Value Measurements". ASU No. 2010-06 amends FASB Accounting Standards Codification Topic 820, Fair Value Measurements and Disclosures, to require additional disclosures regarding fair value measurements. Certain disclosures required by ASU No. 2010-06 are effective for interim and annual reporting periods beginning after December 15, 2009, and other required disclosures are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. Management has evaluated the impact and has incorporated the disclosures required by ASU No. 2010-06 in its financial statement disclosures.

### 3. Derivative Instruments

The Fund intends to use derivatives primarily to economically hedge against risks in the portfolio, namely interest rate risk and credit risk. Historically the Fund has used options on treasury futures contracts for the purpose of economically hedging against a significant increase in long-term interest rates. When the strategy

**NOTES TO FINANCIAL STATEMENTS (Continued)**

has been employed, the Fund would purchase put options on treasury futures contracts that would increase in value if long-term interest rates increased significantly, offsetting some of the related decline in portfolio asset values. The Fund has also purchased and written call options on treasury futures contracts to supplement the put option strategy and also to reduce the overall cost of the interest rate hedge (by earning premiums from the net sale of call options).

The Fund has the authority to use other derivatives for hedging or to increase expected return, but has not employed any of these derivatives to-date and does not anticipate broad use of these derivatives in the near future (although this may change without advance notice). Other approved derivatives strategies include: buying and selling credit default swaps, interest rate swaps and options thereon (swaptions), and options on securities. Accounting policies for specific derivatives, including the location of these items in the financial statements, are included in Note 2 as appropriate. No assurance can be given that such use of derivatives will achieve their desired purposes or, in the case of hedging, will result in an overall reduction of risk to the Fund.

The Fund did not use any derivatives during the fiscal years ended November 30, 2009 and November 30, 2010.

*Options on Financial Futures Contracts:* When the interest rate hedging strategy is employed, the Fund intends to use options on financial futures contracts in much the same way as described above. The risk associated with purchasing options, and therefore the maximum loss the Fund would incur, is limited to the purchase price originally paid. The risk in writing a call option is that the Fund may forego the opportunity for profit if the market price of the underlying security increases and the option is exercised. The risk in writing a put option is that the Fund may incur a loss if the market price of the underlying security decreases and the option is exercised.

**4. Investment Advisory Fee, Administration Fee, Transfer Agent Fee, Custodian Fee, Directors' Fees and Chief Compliance Officer 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 total managed assets up to \$100 million and 0.50% of the Fund's average monthly total managed assets of \$100 million or more.

For purposes of calculating the fees payable to the Adviser, Administrator and Custodian, the Fund's total managed assets means the total assets of the Fund (including any assets attributable to the Fund's preferred stock that may be outstanding or otherwise attributable to the use of leverage) minus the sum of accrued liabilities (other than debt, if any, representing financial leverage). For purposes of determining total managed assets, the liquidation preference of any outstanding preferred shares issued by the Fund is not treated as a liability.

BNY Mellon Investment Servicing (US) Inc. ("BNY Mellon") (formerly known as PNC Global Investment Servicing (U.S.) Inc.) serves as the Fund's Administrator. As Administrator, BNY Mellon calculates the net asset value of the Fund's shares attributable to Common Stock and generally assists in all aspects of the Fund's administration and operation. As compensation for BNY Mellon's services as Administrator, the Fund pays BNY Mellon a monthly fee at an annual rate of 0.10% of the first \$200 million of the Fund's average

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

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weekly total managed assets, 0.04% of the next \$300 million of the Fund's average weekly total managed assets, 0.03% of the next \$500 million of the Fund's average weekly total managed assets and 0.02% of the Fund's average weekly total managed assets above \$1 billion.

BNY Mellon also serves as the Fund's Common Stock dividend-paying agent and registrar (Transfer Agent). As compensation for BNY Mellon's services, the Fund pays BNY Mellon a fee at an annual rate of 0.02% of the first \$150 million of the Fund's average weekly net assets attributable to Common Stock, 0.0075% of the next \$350 million of the Fund's average weekly net assets attributable to Common Stock, and 0.0025% of the Fund's average weekly net assets attributable to Common Stock above \$500 million, plus certain out of pocket expenses. For the purpose of calculating such fee, the Fund's average weekly net assets attributable to Common Stock are deemed to be the average weekly value of the Fund's total assets minus the sum of the Fund's liabilities. For this calculation, the Fund's liabilities are deemed to include the aggregate liquidation preference of any outstanding preferred shares and the loan principal balance.

PFPC Trust Company ("PFPC Trust"), a member of BNY Mellon, serves as the Fund's Custodian. 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 first \$200 million of the Fund's average weekly total managed assets, 0.008% of the next \$300 million of the Fund's average weekly total managed assets, 0.006% of the next \$500 million of the Fund's average weekly total managed assets and 0.005% of the Fund's average weekly total managed assets above \$1 billion.

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 \$750 for each in-person meeting of the Board of Directors or Audit Committee, \$500 for each in-person meeting of the Nominating Committee, and \$250 for each telephone meeting. The Audit Committee Chairman receives an additional annual fee of \$3,000. The Fund also reimburses all Directors for travel and out-of-pocket expenses incurred in connection with such meetings.

The Fund currently pays the Adviser a fee of \$37,500 per annum for Chief Compliance Officer services and reimburses out-of-pocket expenses incurred in connection with providing services in this role.

### **5. Purchases and Sales of Securities**

For the year ended November 30, 2010, the cost of purchases and proceeds from sales of securities excluding short-term investments, aggregated \$73,762,167 and \$63,747,067, respectively.

At November 30, 2010, the aggregate cost of securities for federal income tax purposes was \$180,078,384, the aggregate gross unrealized appreciation for all securities in which there is an excess of value over tax cost was \$26,743,815 and the aggregate gross unrealized depreciation for all securities in which there is an excess of tax cost over value was \$20,671,856.

**NOTES TO FINANCIAL STATEMENTS (Continued)****6. Common Stock**

At November 30, 2010, 240,000,000 shares of \$0.01 par value Common Stock were authorized.

Common Stock transactions were as follows:

	Year Ended 11/30/10		Year Ended 11/30/09	
	Shares	Amount	Shares	Amount
Shares issued under the Dividend Reinvestment and Cash Purchase Plan . . . . .	87,985	\$986,882	85,637	\$566,685

**7. Auction Preferred Stock (APS)**

The Fund's Articles of Incorporation authorize the issuance of up to 10,000,000 shares of \$0.01 par value preferred stock. Prior to July 14, 2009, the Fund had preferred stock issued in the form of APS. The APS was senior to the Common Stock and resulted in the financial leveraging of the Common Stock. As of July 14, 2009, the Fund redeemed and cancelled the last remaining shares of APS and does not currently have any issued and outstanding shares of preferred stock. Although the APS was redeemed, certain additional distributions were owed to previous holders and were paid in December, 2009.

The Fund redeemed APS shares as detailed in the table below. Shares were redeemed at a redemption price equal to the liquidation preference of \$100,000 per share, plus the amount of accumulated but unpaid dividends for each redemption date, respectively. The Fund utilized proceeds from its debt facility (See Note 8) for the last redemption. After these redemptions, borrowings from its debt facility were the Fund's sole source of leverage.

Redemption Date	\$ Amount of APS
November 12, 2008	\$15,000,000*
November 12, 2008	8,100,000*
November 20, 2008	2,100,000*
April 7, 2009	10,000,000*
July 14, 2009	44,800,000

\* Shares were redeemed on the dates reflected; however, from the Fund's perspective, the November 12<sup>th</sup> (\$8,100,000) and November 20<sup>th</sup> redemptions were effective as of October 24, 2008, the November 12<sup>th</sup> (\$15,000,000) redemption was effective as of November 7, 2008 and the April 7<sup>th</sup> redemption was effective as of February 24, 2009. In all cases, the earlier effective date was due to the unconditional deposit of funds with the paying agent.

**8. Committed Financing Agreement**

The Fund entered into a committed financing agreement ("Financing Agreement") on June 26, 2009 which allowed the Fund to borrow up to an initial limit of \$44.8 million on a secured basis. The primary use of the initial proceeds was to redeem the outstanding shares of APS (See Note 7), although the Fund will use the borrowing facility in the normal course of business as financial leverage. Such leveraging tends to magnify both the risks and opportunities to Shareholders. The Financing Agreement has been amended from time to time to allow for changes in the committed amount. As of November 30, 2010, the committed amount, and amount borrowed under the Financing Agreement was \$60.5 million.

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

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The lender charges an annualized rate of 1.00% on the undrawn (committed) balance, and three-month LIBOR (reset quarterly) plus 1.10% on the drawn (borrowed) balance. Effective January 1, 2011 (subsequent to the reporting period), the interest rates charged by the lender will be reduced. The annualized rate on the undrawn balance will be 0.80% and the rate on the drawn balance will be three-month LIBOR (reset quarterly) plus 0.95%. For the year ended November 30, 2010, the daily weighted average annualized interest rate on the drawn balance was 1.443% and the average daily loan balance was \$58,342,466. The Fund paid the lender an arrangement fee (at the origination of the facility) equal to 0.50% of the committed amount of \$44.8 million. The arrangement fee was amortized to expense over a period of approximately eighteen months. LIBOR 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 Shareholders.

The Fund is required to meet certain asset coverage requirements under the Financing Agreement and under the 1940 Act. In accordance with the asset coverage requirements, at least two-thirds of the Fund's assets are expected to be pledged as collateral assuming the full committed amount is drawn. Securities pledged as collateral are identified in the portfolio of investments. If the Fund fails to meet these requirements, or maintain other financial covenants required under the Financing Agreement, the Fund may be required to repay immediately, in part or in full, the amount borrowed under the Financing Agreement. Additionally, failure to meet the foregoing requirements or covenants could restrict the Fund's ability to pay dividends to Shareholders and could necessitate sales of portfolio securities at inopportune times. The Financing Agreement has no stated maturity, but may be terminated by either party without cause with six months' advance notice.

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

The Fund invests primarily in a diversified portfolio of preferred securities. This includes traditional preferred stocks eligible for the inter-corporate dividends received deduction ("DRD") and 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 companies in the utilities industry and at least 25% of its total 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 Fund may invest up to 25% of its assets at the time of purchase in securities rated below investment grade. These securities must be rated at least either "Ba3" by Moody's Investors Service, Inc. or "BB-" by Standard & Poor's or, if unrated, judged to be comparable in quality by the Adviser, in any case, at the time of purchase. However, these securities must be issued by an issuer having a class of senior debt rated investment grade outstanding.

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 will be subject to the foregoing 20% limitation to the extent that, in the opinion of the Adviser, such investments are deemed to be debt-like in key characteristics. Typically, a security will not be considered



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

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debt-like (a) if an issuer can defer payment of 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.

In addition to foreign money market securities, the Fund may invest up to 30% of its total assets in the securities of companies organized or having their principal place of business outside the United States. All foreign securities held by the Fund will be denominated in U.S. dollars.

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. The Fund may also enter into transactions, in accordance with its investment policies, involving short sales of securities and purchases of securities on margin. Such transactions may expose the Fund to credit and market valuation risk greater than that associated with regular trade settlement procedures.

### **10. Securities Lending**

The Fund may lend up to 15% of its total assets (including the value of the loan collateral) to certain qualified brokers in order to earn additional income. The Fund receives compensation in the form of fees or interest earned on the investment of any cash collateral received. The Fund also continues to receive interest and dividends on the securities loaned. The Fund receives collateral in the form of cash or securities with a market value at least equal to the market value of the securities on loan, including accrued interest. In the event of default or bankruptcy by the borrower, the Fund could experience delays and costs in recovering the loaned securities or in gaining access to the collateral. The Fund has the right under the lending agreement to recover the securities from the borrower on demand. As of November 30, 2010 there were no securities on loan by the Fund.

### **11. Subsequent Events**

Management has evaluated the impact of all subsequent events on the Fund through the date the financial statements were issued, and has determined that there were no subsequent events requiring recognition or disclosure in the financial statements.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders  
Flaherty & Crumrine Preferred Income Fund Incorporated

We have audited the accompanying statement of assets and liabilities of Flaherty & Crumrine Preferred Income Fund Incorporated, including the portfolio of investments, as of November 30, 2010, and the related statement of operations for the year then ended, the statements of changes in net assets for each of the years in the two-year period then ended, the statement of cash flows for the year then ended, and the financial highlights for each of the years in the five-year period 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 audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the 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, 2010 by correspondence with the custodian and brokers, or by other appropriate auditing procedures where replies from brokers were not received. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of Flaherty & Crumrine Preferred Income Fund Incorporated as of November 30, 2010, the results of its operations and its cash flows for the year then ended, the changes in its net assets for each of the years in the two-year period then ended, and the financial highlights for each of the years in the five-year period then ended, in conformity with U.S. generally accepted accounting principles.

**KPMG LLP**

Boston, Massachusetts  
January 24, 2011

## **ADDITIONAL INFORMATION (Unaudited)**

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### **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 or her own name will have all distributions reinvested automatically by BNY Mellon 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, BNY Mellon will buy shares of the Fund's Common Stock in the open market, on the New York Stock Exchange ("NYSE") 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 BNY Mellon 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, BNY Mellon 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 BNY Mellon's open market purchases in connection with the reinvestment of dividends or capital gains distributions. For the year ended November 30, 2010, no 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 payment date, a dividend or distribution in an amount equal to the cash that the participant could have received instead of shares.

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

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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 by BNY Mellon under the Plan.

A shareholder whose Common Stock is registered in his or her own name may terminate participation in the Plan at any time by notifying BNY Mellon in writing, by completing the form on the back of the Plan account statement and forwarding it to BNY Mellon, or by calling BNY Mellon directly. A termination will be effective immediately if notice is received by BNY Mellon 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, BNY Mellon 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 BNY Mellon at 1-866-351-7446.

### **Proxy Voting Policies and Proxy Voting Record on Form N-PX**

The Fund files Form N-PX with its complete proxy voting record for the 12 months ended June 30<sup>th</sup> no later than August 31<sup>st</sup> of each year. The Fund filed its latest Form N-PX with the Securities and Exchange Commission ("SEC") on August 23, 2010. This filing, as well as the Fund's proxy voting policies and procedures, are available (i) without charge, upon request, by calling the Fund's transfer agent at 1-866-351-7446 and (ii) on the SEC's website at [www.sec.gov](http://www.sec.gov). In addition, the Fund's proxy voting policies and procedures are available on the Fund's website at [www.preferredincome.com](http://www.preferredincome.com).

### **Portfolio Schedule on Form N-Q**

The Fund files a complete schedule of portfolio holdings with the SEC for the first and third fiscal quarters on Form N-Q, the latest of which was filed for the quarter ended August 31, 2010. The Fund's Form N-Q is available on the SEC's website at [www.sec.gov](http://www.sec.gov) or may be viewed and obtained from the SEC's Public Reference Room in Washington D.C. Information on the operation of the Public Reference Section may be obtained by calling 1-800-SEC-0330.

### **Portfolio Management Team**

In managing the day-to-day operations of the Fund, the Adviser relies on the expertise of its team of money management professionals, consisting of Messrs. Crumrine, Ettinger, Stone and Chadwick. The professional backgrounds of each member of the management team are included in the "Information about Fund Directors and Officers" section of this report.

**ADDITIONAL INFORMATION (Unaudited) (Continued)****Supplementary Tax Information**

Distributions to Common Stock Shareholders are characterized as follows for purposes of Federal income taxes (as a percentage of total distributions):

	<u>Individual Shareholder</u>		<u>Corporate Shareholder</u>	
	<u>QDI</u>	<u>Ordinary Income</u>	<u>DRD</u>	<u>Ordinary Income</u>
Fiscal Year 2010	51.21%	48.79%	21.89%	78.11%
Calendar Year 2010	51.53%	48.47%	20.82%	79.18%

Qualified Dividend Income (“QDI”) distributions are taxable at a maximum 15% personal tax rate.

**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>David Gale</b> Delta Dividend Group, Inc. 220 Montgomery Street Suite 426 San Francisco, CA 94104 Age: 61	Director	Class I Director since January 1997	President of Delta Dividend Group, Inc. (investments)	4	
<b>Morgan Gust</b> 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 63	Director	Class III Director since January 1991	Owner and operator of various entities engaged in agriculture and real estate; Former President of Giant Industries, Inc. (petroleum refining and marketing) from March 2002 through June 2007	4	CoBiz, Financial, Inc. (financial services)

\* 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 2011 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 2012 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

**Class III Director** – three year term expires at the Fund’s 2013 Annual Meeting of Shareholders; director may continue in office until his successor is duly elected and qualified.

\*\* Each Director also serves as a Director for Flaherty & Crumrine Preferred Income Opportunity Fund, Flaherty & Crumrine/Claymore Preferred Securities Income Fund, and Flaherty & Crumrine/Claymore Total Return Fund.

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

<b>Name, Address, and Age</b>	<b>Position(s) Held with Fund</b>	<b>Term of Office and Length of Time Served*</b>	<b>Principal Occupation(s) During Past Five Years</b>	<b>Number of Funds in Fund Complex Overseen by Director</b>	<b>Other Directorships Held by Director**</b>
<b>NON-INTERESTED DIRECTORS:</b>					
<b>Karen H. Hogan†</b> 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 49	Director	Class I Director since April 2005	Active Committee Member and Volunteer to several non-profit organizations; from September 1985 to January 1997, Senior Vice President of Preferred Stock Origination at Lehman Brothers and Previously, Vice President of New Product Development	4	
<b>Robert F. Wulf</b> P.O. Box 753 Neskowin, OR 97149 Age: 73	Director and Audit Committee Chairman	Class II Director since January 1991	Financial Consultant; Trustee, University of Oregon Foundation; Trustee, San Francisco Theological Seminary	4	
<b>INTERESTED DIRECTOR:</b>					
<b>Donald F. Crumrine†, ††</b> 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 63	Director, Chairman of the Board and Chief Executive Officer	Class II Director since January 1991	Chairman of the Board and Director of Flaherty & Crumrine Incorporated	4	

\* 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:

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\*\* Each Director also serves as a Director for Flaherty & Crumrine Preferred Income Opportunity Fund, Flaherty & Crumrine/Claymore Preferred Securities Income Fund, and Flaherty & Crumrine/Claymore Total Return Fund.

† As a Director, until July 14, 2009, represented holders of shares of the Fund's Auction Preferred Stock.

†† "Interested person" of the Fund as defined in the 1940 Act. Mr. Crumrine is considered an "interested person" because of his affiliation with Flaherty & Crumrine Incorporated, which acts as the Fund's investment adviser.

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

<b>Name, Address, and Age</b>	<b>Position(s) Held with Fund</b>	<b>Term of Office and Length of Time Served</b>	<b>Principal Occupation(s) During Past Five Years</b>
<b>OFFICERS</b>			
<b>Robert M. Ettinger</b> 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 52	President	Since October 2002	President and Director of Flaherty & Crumrine Incorporated
<b>R. Eric Chadwick</b> 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 35	Chief Financial Officer, Vice President and Treasurer	Since July 2004	Director of Flaherty & Crumrine Incorporated since June 2006; Vice President of Flaherty & Crumrine Incorporated
<b>Chad C. Conwell</b> 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 38	Chief Compliance Officer, Vice President and Secretary	Since July 2005	Chief Compliance Officer of Flaherty & Crumrine Incorporated since September 2005; Vice President of Flaherty & Crumrine Incorporated since July 2005
<b>Bradford S. Stone</b> 47 Maple Street Suite 403 Summit, NJ 07901 Age: 51	Vice President and Assistant Treasurer	Since July 2003	Director of Flaherty & Crumrine Incorporated since June 2006; Vice President of Flaherty & Crumrine Incorporated
<b>Laurie C. Lodolo</b> 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 47	Assistant Compliance Officer, Assistant Treasurer and Assistant Secretary	Since July 2004	Assistant Compliance Officer and Secretary of Flaherty & Crumrine Incorporated
<b>Linda M. Puchalski</b> 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 54	Assistant Treasurer	Since August 2010	Administrator of Flaherty & Crumrine Incorporated

## Directors

Donald F. Crumrine, CFA  
Chairman of the Board  
David Gale  
Morgan Gust  
Karen H. Hogan  
Robert F. Wulf, CFA

## Officers

Donald F. Crumrine, CFA  
Chief Executive Officer  
Robert M. Ettinger, CFA  
President  
R. Eric Chadwick, CFA  
Chief Financial Officer,  
Vice President and Treasurer  
Chad C. Conwell  
Chief Compliance Officer,  
Vice President and Secretary  
Bradford S. Stone  
Vice President and  
Assistant Treasurer  
Laurie C. Lodolo  
Assistant Compliance Officer,  
Assistant Treasurer and  
Assistant Secretary  
Linda M. Puchalski  
Assistant Treasurer

## Investment Adviser

Flaherty & Crumrine Incorporated  
e-mail: [flaherty@pfdincome.com](mailto:flaherty@pfdincome.com)

## Questions concerning your shares of Flaherty & Crumrine 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 —  
BNY Mellon Shareowner Services  
P.O. Box 358035  
Pittsburgh, PA 15252-8035  
1-866-351-7446

**This report is sent to shareholders of Flaherty & Crumrine 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.**



Flaherty & Crumrine  

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PREFERRED INCOME FUND

# Annual Report

November 30, 2010

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