

PREFERRED INCOME FUND INCORPORATED

Dear Shareholder:

The bond and preferred securities markets paused for a rest in the first quarter of fiscal 2002, and the Preferred Income Fund reflected the lull. The Fund's total return on net asset value ("NAV") of -0.4% almost "broke even" for the three months ending February 28, 2002. For the trailing twelve months through February, the total return on NAV of 10.6% was considerably more robust.

The recent steady stream of upbeat economic reports suggests that the economic slump in this country may have hit bottom. So far, the Federal Reserve has held short-term interest rates steady at very low levels, reflecting the tentative nature of a potential business recovery. The Fed also appears to be taking comfort from the lack of visible inflationary pressures (with the possible exception of oil prices).

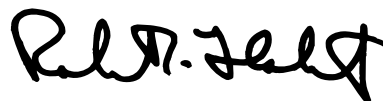
Low short-term interest rates hold down the cost of the Fund's leverage, which boosts our net income. This is the same phenomenon that recently allowed the Fund to pay a year-end extra dividend. It is entirely possible that increases in short-term rates in upcoming months could cut into this "surplus income". For the moment, however, income is starting to accumulate again.

We are working on a possible increase in the Fund's leverage. The Fund's assets have grown over time, but the amount of its leverage has stayed the same. It now appears that we may be able to overcome some of the obstacles that have kept us from adjusting the leverage in the past. One possibility would be to increase the proportion of the Fund's assets represented by leverage to roughly the level where the Fund's sister fund, Preferred Income Opportunity Fund, has operated very successfully for years. Of course, there is no guarantee at this point what may happen.

Long-term interest rates seem to be anticipating stronger demand for capital as the economy recovers. Long-term Treasury yields edged up just over $\frac{1}{8}\%$ in the first fiscal quarter, which was not enough to make the Fund's hedges "pay off". However, a more dramatic jump in long-term rates so far in March has since put those hedges "in-the-money". The Fund's hedges are a key component of its strategy that is generally expected to result in income increasing when interest rates rise significantly, while being relatively resistant to the impact of significant declines in rates.

Despite signs of a possible economic recovery, many sectors of the securities markets are still feeling the effects of the binge that the economy enjoyed before its fall. The Enron/Arthur Andersen debacle is the most obvious example. The bottom line is that financial excess is "out", and fiscal conservatism and full disclosure are making a comeback. The adjustment is painful for some, but it is good medicine for the future.

Sincerely,



Robert T. Flaherty
Chairman of the Board

March 21, 2002

Preferred Income Fund Incorporated
SUMMARY OF INVESTMENTS
February 28, 2002 (Unaudited)

| | <u>Value (000's)</u> | <u>Percent of Total Net Assets</u> |
|--|--------------------------|--|
| Adjustable Rate Preferred Securities | | |
| Utilities | \$ 6,877 | 3.5% |
| Banking | 28,038 | 14.1 |
| Financial Services | <u>1,056</u> | <u>0.5</u> |
| Total Adjustable Rate | <u>35,971</u> | <u>18.1</u> |
| Fixed Rate Preferred Securities | | |
| Utilities | 61,340 | 30.8 |
| Banking | 34,276 | 17.2 |
| Financial Services | 28,418 | 14.3 |
| Insurance | 16,722 | 8.4 |
| Oil and Gas | 6,616 | 3.3 |
| Miscellaneous Industries | <u>6,385</u> | <u>3.2</u> |
| Total Fixed Rate | <u>153,757</u> | <u>77.2</u> |
| Inverse Floating Rate Preferred Securities | 2,123 | 1.1 |
| TOTAL PREFERRED SECURITIES | 191,851 | 96.4 |
| MONEY MARKET FUNDS | 5,050 | 2.5 |
| PURCHASED PUT OPTIONS | <u>1,378</u> | <u>0.7</u> |
| TOTAL INVESTMENTS | 198,279 | 99.6 |
| OTHER ASSETS AND LIABILITIES (Net) | <u>713</u> | <u>0.4</u> |
| TOTAL NET ASSETS | <u>\$198,992</u> | <u>100.0%</u> |

FINANCIAL DATA

Per Share of Common Stock (Unaudited)

| | <u>Dividend Paid</u> | <u>Net Asset Value</u> | <u>NYSE Closing Price</u> | <u>Dividend Reinvestment Price (1)</u> |
|--------------------------------|--------------------------|----------------------------|-------------------------------|--|
| December 31, 2001 | \$0.1640 | \$14.46 | \$14.70 | \$14.46 |
| January 31, 2002 | 0.0820 | 14.40 | 15.20 | 14.77 |
| February 28, 2002 | 0.0820 | 14.24 | 15.50 | 15.20 |

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

Preferred Income Fund Incorporated

STATEMENT OF CHANGES IN NET ASSETS⁽¹⁾
Three Months Ended February 28, 2002 (Unaudited)

| | |
|---|-----------------------|
| OPERATIONS: | |
| Net investment income | \$ 3,132,570 |
| Net realized loss on investments sold | (975,019) |
| Net unrealized depreciation of investments during the period | <u>(2,368,526)</u> |
| Net decrease in net assets from operations | (210,975) |
| DISTRIBUTIONS: | |
| Dividends paid from net investment income to MMP* Shareholders | (486,554) |
| Distributions paid from net realized capital gains to MMP* Shareholders | <u>(3,252,060)</u> |
| Dividends paid from net investment income to Common Stock Shareholders (2) | — |
| Distributions paid from net realized capital gains to Common Stock Shareholders | <u>(3,738,614)</u> |
| Total Distributions | (3,738,614) |
| FUND SHARES TRANSACTIONS: | |
| Increase from Common Stock Transactions | 529,722 |
| NET DECREASE IN NET ASSETS: | (3,419,867) |
| NET ASSETS: | |
| Beginning of period | <u>202,412,035</u> |
| End of period | <u>\$ 198,992,168</u> |

FINANCIAL HIGHLIGHTS⁽¹⁾
Three Months Ended February 28, 2002 (Unaudited)
For a Common share outstanding throughout the period.

| | |
|---|------------------|
| OPERATING PERFORMANCE: | |
| Net asset value, beginning of period | \$ 14.62 |
| Net investment income | 0.32 |
| Net realized loss and unrealized depreciation on investments | <u>(0.34)</u> |
| Net decrease in net asset value resulting from investment operations | (0.02) |
| DISTRIBUTIONS: | |
| Dividends paid from net investment income to MMP* Shareholders | (0.05) |
| Distributions paid from net realized capital gains to MMP* Shareholders | <u>(0.33)</u> |
| Dividends paid from net investment income to Common Stock Shareholders (2) | — |
| Distributions paid from net realized capital gains to Common Stock Shareholders | <u>0.02</u> |
| Change in accumulated undeclared dividends on MMP* | <u>(0.36)</u> |
| Total distributions | <u>(0.36)</u> |
| Net asset value, end of period | \$ 14.24 |
| Market value, end of period | \$ 15.50 |
| Common shares outstanding, end of period | <u>9,933,387</u> |
| RATIOS TO AVERAGE NET ASSETS AVAILABLE TO COMMON STOCK SHAREHOLDERS: | |
| Net investment income | 8.14%** |
| Operating expenses | 1.33%** |
| SUPPLEMENTAL DATA:†† | |
| Portfolio turnover rate fiscal year to date | 5% |
| Net assets, end of period (in 000's) | \$ 198,992 |
| Ratio of operating expenses to total average net assets including MMP* | 0.95%** |

(1) These tables summarize the three months ended February 28, 2002 and should be read in conjunction with the Fund's audited financial statements, including footnotes, in its Annual Report dated November 30, 2001.

(2) Includes dividends earned, but not paid out, in prior fiscal year.

* Money Market Cumulative Preferred™ Stock.

** Annualized.

†† Information presented under Supplemental Data includes MMP*.

Directors

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

Officers

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

Investment Adviser

Flaherty & Crumrine Incorporated
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**Questions concerning your shares of Preferred
Income Fund?**

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

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



**Quarterly
Report**

February 28, 2002

web site: www.preferredincome.com