

## FLAHERTY & CRUMRINE PREFERRED INCOME FUND

To the Shareholders of the Flaherty & Crumrine Preferred Income Fund (“PFD”):

The first fiscal quarter of 2006 was a mixed bag for PFD. On the plus side, for the three-month period ended February 28, 2006, the Fund produced a total return on net asset value of **+3.8%**. Despite this strong investment performance, net income available to shareholders has declined, and the Fund reduced its monthly dividend by 5.0% (from \$0.0905/share to \$0.086/share), beginning with the March distribution. The focus of the Fund is income, so the decision to reduce the dividend was difficult, but necessary.

The total return calculation mentioned above has two basic components—net income earned and net change in principal value. Recently, the latter has done well while the former has come under some pressure.

Net income earned, the amount of investment income left over after payments on the Fund’s Money Market Preferred (“MMP<sup>®</sup>”) shares and other expenses, is what the Fund can pay out in monthly distributions to common shareholders. Although investment income has increased recently, payments to MMP<sup>®</sup> shares have risen at a faster pace. As a result, the Fund could not continue to distribute common dividends at the same rate.

The MMP<sup>®</sup> rate is closely correlated to other short-term interest rates, all of which have moved up in concert with the Federal Reserve’s efforts to influence the pace of economic activity. The MMP<sup>®</sup> rate has risen from a low of 1.02% in April 2004 to 3.35% in March 2006. Despite this jump in rates, the use of MMP<sup>®</sup> leverage continues to add incremental income for common shares because the money we obtain from leverage is being invested in securities with much higher yields.

The other component of total return, principal change, normally is not distributed to common shareholders, but instead is reflected by changes in the Fund’s net asset value. During the fiscal period, the Fund’s NAV rose 2.0%.

One last comment on total return—whatever the breakdown between net income and principal change, the entire amount belongs to common shareholders. In addition, the two tend to “merge” over time. For example, if principal value increases and the Fund can realize gains, the Fund will have more money to invest and can generate additional income. Or, shareholders can use the income they receive to purchase additional shares via the Dividend Reinvestment Plan to increase the value of their investment.

As readers may recall from previous discussions of market conditions, the preferred securities market has two main segments—issues that pay dividends and those that pay interest. We refer to the first type as “traditional” preferred stock and the second as “hybrid” preferred securities.

Investor demand for traditional preferred stock has been consistently strong for some time now; however new issue supply has not kept up—during the last fiscal quarter there were only two new issues, totaling a meager \$300 million. As a result of this imbalance, this segment has slowly and steadily outperformed other types of fixed-income securities. The solid performance of PFD reflects the portfolio’s emphasis on traditional preferred stock.

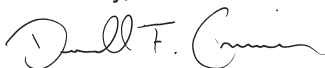
Although demand for hybrid securities has also been strong for some time, the supply of new hybrid preferred has greatly exceeded the supply of traditional preferred. During the period there were thirty new hybrid issues with a market value of \$13.2 *billion*. As expected, many of these new issues were structured like the “ECAP” issues we discussed in our last letter (and on the Fund’s website). Even with this sizable amount of new supply, the performance of this segment kept pace with most other types of fixed-income securities during the quarter.

Many of the recent hybrid preferred securities have terms and features that require very close scrutiny. While the basic structure of the enhanced capital security is now fairly well established, with each new issue we are observing small but important differences. This evolutionary process is typical of new structures—our job is to dissect each issue until we fully understand every twist and turn.

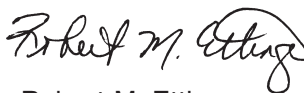
The Fund's hedge positions are intended to provide shareholders with some protection against significant increases in long-term interest rates. Over the course of the fiscal quarter, long-term interest rates barely moved, so the hedging strategy had little impact on the Fund's performance. The Fund's hedging strategy did benefit from the "flat" U.S. Treasury yield curve, since the cost of our hedges tends to be lower in this environment.

We hope investors will take advantage of the Fund's website, [www.preferredincome.com](http://www.preferredincome.com). It contains a wide range of useful and up-to-date information about the Fund. In addition, some of the topics mentioned above are analyzed in greater depth in the Frequently Asked Questions section of the website.

Sincerely,



Donald F. Crumrine  
Chairman of the Board



Robert M. Ettinger  
President

April 17, 2006

## PORTFOLIO OVERVIEW

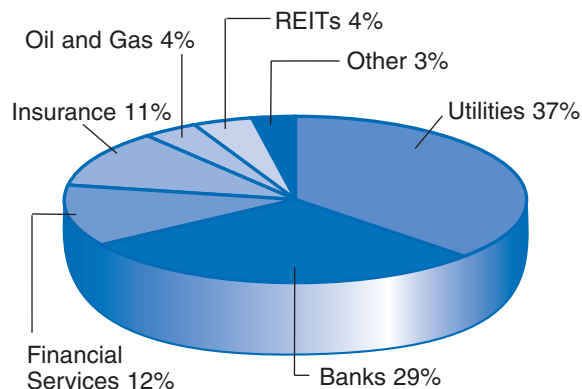
February 28, 2006 (Unaudited)

### Fund Statistics on 02/28/06

Net Asset Value	\$	15.57
Market Price	\$	16.65
Premium		6.94%
Yield on Market Price		6.52%
Common Shares Outstanding		10,396,941

### Industry Categories

% of Portfolio



Moody's Ratings	% of Portfolio
AAA	0.7%
AA	4.0%
A	20.6%
BBB	45.9%
BB	16.2%
Not Rated	11.4%
Below Investment Grade*	17.8%

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

### Top 10 Holdings by Issuer

% of Portfolio

Interstate Power	5.3%
Lehman Brothers	4.2%
FBOP Corporation	3.7%
North Fork Bancorporation	3.5%
Xcel Energy	3.2%
SLM Corporation	3.2%
Principal Financial Group	3.1%
HSBC	2.9%
Cobank	2.8%
Entergy Louisiana	2.7%

	% of Portfolio**
Holdings Generating Qualified Dividend Income (QDI) for Individuals	70%
Holdings Generating Income Eligible for the Corporate Dividend Received Deduction (DRD)	66%

\*\* 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.

**PORTFOLIO OF INVESTMENTS**

February 28, 2006 (Unaudited)

<u>Shares/\$ Par</u>		<u>Value</u>
<b>Preferred Securities — 97.1%</b>		
<b>Banking — 27.8%</b>		
\$ 3,000,000	Astoria Capital Trust I, 9.75% 11/01/29 Capital Security, Series B .....	\$ 3,520,410
54,700	BAC Capital Trust I, 7.00% Pfd. 12/15/31 .....	1,401,414
\$ 750,000	Barnett Capital II, 7.95% 12/01/26 Capital Security .....	794,437
\$ 250,000	Chase Capital I, 7.67% 12/01/26 Capital Security .....	263,605
74,700	Citigroup Capital VIII, 6.95% Pfd. ....	1,905,970
	Cobank, ACB:	
50,000	7.00% Pfd., 144A**** .....	2,594,250*
75,000	Adj. Rate Pfd., 144A**** .....	4,110,000*
\$ 500,000	Comerica (Imperial) Capital Trust I, 9.98% 12/31/26 Capital Security, Series B ...	553,162
22,300	BAC Capital Trust III, 7.00% Pfd. ....	570,546
9,000	FBOP Corporation, Adj. Rate Pfd., 144A**** .....	9,067,500*
\$ 2,250,000	First Hawaiian Capital I, 8.343% 07/01/27 Capital Security, Series B .....	2,417,096 <sup>(1)</sup>
	First Republic Bank:	
200,000	6.25% Pfd. ....	4,944,000*
53,700	6.70% Pfd. ....	1,375,526*
\$ 1,500,000	First Union Capital II, 7.95% 11/15/29 Capital Security .....	1,893,960
\$ 7,820,000	GreenPoint Capital Trust I, 9.10% 06/01/27 Capital Security .....	8,495,218
\$ 3,000,000	HBOS Capital Funding LP, 6.85% Pfd. ....	3,028,935 <sup>(1)</sup>
32,625	HSBC Holdings PLC, 6.20% Pfd., Series A .....	811,710 <sup>**<sup>(1)</sup></sup>
5,000	HSBC Series II, Variable Inverse Pfd., Pvt. ....	5,450,000*
6,480	J.P. Morgan Chase & Co., 6.625% Pfd., Series H .....	328,342*
\$ 2,000,000	Keycorp Capital VII, 5.70% 06/15/35 Capital Security .....	1,919,950
\$ 270,000	Keycorp Institutional Capital B, 8.25% 12/15/26 Capital Security .....	286,654
\$ 674,000	NB Capital Trust II, 7.83% 12/15/26 Capital Security .....	712,479
16,000	PFGI Capital Corporation, 7.75% Pfd. ....	425,280
\$ 1,700,000	RBS Capital Trust B, 6.80% Pfd. ....	1,718,734 <sup>**<sup>(1)</sup></sup>
\$ 774,000	Republic New York Capital II, 7.53% 12/04/26 Capital Security .....	814,863 <sup>(1)</sup>
10	Roslyn Real Estate, 8.95% Pfd., Series C, 144A**** .....	1,112,685
1,100	Suntrust Capital V, 7.05% Pfd. 12/15/31 .....	28,182
87,500	USB Capital VIII, 6.35% Pfd. 12/29/65 .....	2,216,375
\$ 3,500,000	Washington Mutual Preferred Funding, Variable Rate Pfd. 03/29/49, 144A**** .....	3,459,470
40,000	Zions Capital Trust B, 8.00% Pfd. 09/01/32 .....	1,037,200
		<u>67,257,953</u>
<b>Financial Services — 12.2%</b>		
141,000	CIT Group, Inc., 6.35% Pfd., Series A .....	3,701,955*
50,000	Fannie Mae, 4.75% Pfd., Series M .....	2,162,250*
53,500	Goldman Sachs Group, Inc., 6.20% Pfd., Series B .....	1,399,025*

**PORTFOLIO OF INVESTMENTS (Continued)**

February 28, 2006 (Unaudited)

<u>Shares/\$ Par</u>		<u>Value</u>
<b>Preferred Securities — (continued)</b>		
<b>Financial Services — (continued)</b>		
	Lehman Brothers Holdings, Inc.:	
43,780	5.67% Pfd., Series D .....	\$ 2,223,367*
154,475	5.94% Pfd., Series C .....	7,927,657*
3,000	Merrill Lynch Series II STRIPES Custodial Receipts, Pvt. ....	3,120,000*
55,000	Morgan Stanley Capital Trust VI, 6.60% Pfd. ....	1,393,700
136,855	SLM Corporation, 6.97% Pfd., Series A .....	7,622,824*
		<u>29,550,778</u>
<b>Insurance — 11.3%</b>		
40,000	ACE Ltd., 7.80% Pfd., Series C .....	1,045,600**(1)
	Aegon NV:	
40,000	6.375% Pfd. ....	1,013,600**(1)
25,000	6.50% Pfd. ....	631,000**(1)
29,750	Arch Capital Group Ltd., 8.00%, Pfd. ....	756,691**(1)
	Axis Capital Holdings:	
22,850	7.25%., Pfd., Series A .....	575,249**(1)
9,300	Variable Rate Pfd., Series B .....	958,597 <sup>(1)</sup>
17,000	Berkley W.R. Capital Trust II, 6.75% 07/26/45 .....	424,235
22,000	Endurance Specialty Holdings, 7.75%, Pfd. ....	551,980**(1)
21,000	Everest Re Capital Trust II, 6.20% Pfd., Series B .....	491,715 <sup>(1)</sup>
140,000	MetLife Inc., 6.50% Pfd., Series B .....	3,677,100*
275,000	Principal Financial Group, 6.518% Pfd. ....	7,585,875*
\$ 4,000,000	Provident Financing Trust I, 7.405% 03/15/38 Capital Security .....	3,951,300
6,300	Renaissancere Holdings, 7.30% Pfd., Series B .....	158,980**(1)
127,000	Scottish Re Group Ltd., 7.25% Pfd. ....	3,239,135**(1)
7,000	St. Paul Capital Trust I, 7.60% Pfd. ....	178,395
\$ 1,250,000	USF&G Capital, 8.312% 07/01/46 Capital Security, 144A**** .....	1,585,963
22,850	XL Capital Ltd., 8.00% Pfd. Series A .....	594,100**(1)
		<u>27,419,515</u>
<b>Utilities — 35.6%</b>		
	Alabama Power Company:	
300	4.52% Pfd. ....	26,082*
5,734	4.72% Pfd. ....	520,561*
200,000	5.30% Pfd. ....	4,979,000*
10,000	Baltimore Gas & Electric Company, 6.70% Pfd., Series 1993 .....	1,039,350*
	Central Hudson Gas & Electric Corporation:	
5,000	4.35% Pfd., Series D, Pvt. ....	437,250*
900	4.96% Pfd., Series E, Pvt. ....	83,970*

**PORTFOLIO OF INVESTMENTS (Continued)**

February 28, 2006 (Unaudited)

<u>Shares/\$ Par</u>		<u>Value</u>
<b>Preferred Securities — (continued)</b>		
<b>Utilities — (continued)</b>		
11,119	Central Vermont Public Service Corporation, 8.30% Sinking Fund Pfd., Pvt. . . . .	\$ 1,154,541*
	Connecticut Light & Power Company:	
2,124	4.50% Pfd., Pvt. . . . .	85,523*
34,300	5.28% Pfd., Series 1967 . . . . .	1,650,344*
1,905	6.56% Pfd., Series 1968 . . . . .	98,384*
15,778	\$3.24 Pfd. . . . .	825,268*
2,100	Consolidated Edison Company of New York, 4.65% Pfd., Series C . . . . .	188,926*
2,886	Dayton Power and Light Company, 3.90% Pfd., Series C . . . . .	196,133*
\$ 1,500,000	Dominion Resources Capital Trust III, 8.40% 01/15/31 . . . . .	1,800,082
	Duquesne Light Company:	
7,675	4.10% Pfd. . . . .	276,914*
9,190	4.15% Pfd. . . . .	335,619*
910	4.20% Pfd. . . . .	33,634*
40,575	6.50% Pfd. . . . .	2,099,756*
5,490	\$2.10 Pfd., Series A . . . . .	202,910*
5,000	Energy East Capital Trust I, 8.25% Pfd. . . . .	127,400
	Entergy Arkansas, Inc.:	
5,574	7.32% Pfd. . . . .	581,006*
11,350	7.40% Pfd. . . . .	1,179,095*
6,253	7.80% Pfd. . . . .	653,032*
3,822	7.88% Pfd. . . . .	398,272*
30,266	\$1.96 Pfd. . . . .	757,407*
4,555	Entergy Gulf States, Inc., 7.56% Pfd. . . . .	448,053*
	Entergy Louisiana, Inc.:	
36,000	6.95% Pfd., 144A**** . . . . .	3,725,640*
260	7.84% Pfd. . . . .	27,145*
106,538	8.00% Pfd., Series 92 . . . . .	2,685,290*
5,000	Entergy Mississippi, Inc., 4.92% Pfd. . . . .	409,450*
	Florida Power Company:	
5,157	4.60% Pfd. . . . .	471,092*
18,535	4.75% Pfd. . . . .	1,748,407*
50,000	Georgia Power Capital Trust V, 7.125% Pfd. . . . .	1,286,500
2,010	Great Plains Energy, Inc., 4.50% Pfd. . . . .	171,111*
24,000	Gulf Power Company, 6.00% Pfd., Series 1 . . . . .	2,490,480*
\$ 3,500,000	Houston Light & Power Capital Trust II, 8.257%, 02/01/37 Capital Security . . . . .	3,708,862
32,650	Indianapolis Power & Light Company, 5.65% Pfd. . . . .	3,135,543*
384,000	Interstate Power & Light Company, 8.375% Pfd., Series B . . . . .	12,781,440*
14,250	Narragansett Electric Company, 4.64% Pfd. . . . .	671,460*

**PORTFOLIO OF INVESTMENTS (Continued)**

February 28, 2006 (Unaudited)

<u>Shares/\$ Par</u>		<u>Value</u>
<b>Preferred Securities — (continued)</b>		
<b>Utilities — (continued)</b>		
	Northern Indiana Public Service Company:	
3,905	7.44% Pfd. ....	\$ 398,681*
7,465	Adj. Rate Pfd., Series A ....	375,116*
6,170	Ohio Edison Company, 4.44% Pfd. ....	503,318*
	Pacific Enterprises:	
27,430	\$4.50 Pfd. ....	2,394,639*
10,000	\$4.75 Pfd., Series 53 ....	921,500*
	Pacific Gas & Electric Co.:	
7,600	4.50% Pfd., Series H ....	151,924*
41,500	5.00% Pfd., Series D ....	882,912*
79,086	5.00% Pfd., Series E ....	1,741,078*
	PacifiCorp:	
1,095	5.40% Pfd. ....	110,885*
1,225	\$4.56 Pfd. ....	103,016*
14,542	\$4.72 Pfd. ....	1,265,808*
12,333	\$7.48 Sinking Fund Pfd. ....	1,268,387*
9,666	Portland General Electric, 7.75% Sinking Fund Pfd. ....	993,520*
5,000	PPL Electric Utilities Corporation, 6.75% Pfd. ....	521,950*
10,000	Public Service Company of New Mexico, 4.58% Pfd., Series 1965 ....	803,400*
	San Diego Gas & Electric Company:	
1,200	4.40% Pfd. ....	20,388*
700	4.50% Pfd. ....	12,166*
77,000	\$1.70 Pfd. ....	1,996,610*
13,100	Savannah Electric & Power Company, 6.00% Pfd. ....	351,538*
	South Carolina Electric & Gas Company:	
25,373	5.125% Purchase Fund Pfd., Pvt. ....	1,303,411*
6,703	6.00% Purchase Fund Pfd., Pvt. ....	341,049*
54,100	Southern California Edison, 4.08% Pfd. ....	1,034,663*
75,000	Southern Union Company, 7.55% Pfd. ....	1,981,500*
\$ 750,000	TXU Electric Capital V, 8.175% 01/30/37 Capital Security ....	792,109
	Union Electric Company:	
14,150	4.56% Pfd. ....	1,283,547*
4,000	\$7.64 Pfd. ....	414,320*
12,500	Virginia Electric & Power Company, \$7.05 Pfd. ....	1,278,688*
11,200	Virginia Power Capital Trust, 7.375% Pfd. 07/30/42 ....	286,608
	Wisconsin Power & Light Company:	
1,220	4.50% Pfd. ....	106,555*
546	4.80% Pfd. ....	50,377*
13,000	6.20% Pfd. ....	1,332,175*

**PORTFOLIO OF INVESTMENTS (Continued)**

February 28, 2006 (Unaudited)

<u>Shares/\$ Par</u>		<u>Value</u>
<b>Preferred Securities — (continued)</b>		
<b>Utilities — (continued)</b>		
	Xcel Energy, Inc.:	
16,030	\$4.08 Pfd., Series B .....	\$ 1,311,094*
26,200	\$4.10 Pfd., Series C .....	2,153,247*
22,000	\$4.11 Pfd., Series D .....	1,812,580*
17,750	\$4.16 Pfd., Series E .....	1,480,173*
10,000	\$4.56 Pfd., Series G .....	914,100*
		<u>86,183,964</u>
<b>Oil and Gas — 4.2%</b>		
8,000	Devon Energy Corporation, 6.49% Pfd., Series A .....	808,440*
5,985	EOG Resources, Inc., 7.195% Pfd., Series B .....	6,299,272*
\$ 1,675,000	KN Capital Trust III, 7.63% 04/15/28 Capital Security .....	1,866,578
10,000	Lasmo America Limited, 8.15% Pfd., 144A**** .....	1,084,900*(1)
		<u>10,059,190</u>
<b>Real Estate Investment Trust (REIT) — 4.1%</b>		
31,000	AMB Property Corporation, 7.00%, Pfd., REIT, Series O .....	788,020
	Duke Realty Corporation:	
15,000	6.50% Pfd., REIT, Series K .....	369,375
20,000	6.625% Pfd., REIT, Series J .....	496,500
1,000	Equity Residential Properties, 8.29% Pfd., REIT, Series K .....	60,305
50,000	HRPT Properties Trust, 7.125% Pfd., REIT, Series C .....	1,252,750
	PS Business Parks, Inc.:	
16,000	7.00% Pfd., REIT, Series H .....	396,560
20,000	7.20% Pfd., REIT, Series M .....	493,700
	Public Storage, Inc.:	
13,300	6.18% Pfd., REIT, Series D .....	316,606
109,270	6.45% Pfd., REIT, Series F .....	2,659,085
10,000	6.45% Pfd., REIT, Series X .....	246,250
22,500	6.75% Pfd., REIT, Series E .....	562,838
3,500	7.125% Pfd., REIT .....	90,843
40,000	Realty Income Corporation, 7.375% Pfd., REIT, Series D .....	1,032,400
	Regency Centers Corporation:	
7,600	6.70% Pfd., REIT .....	185,478
40,000	7.25% Pfd., REIT .....	1,004,600
		<u>9,955,310</u>

**PORTFOLIO OF INVESTMENTS (Continued)**

February 28, 2006 (Unaudited)

<u>Shares/\$ Par</u>		<u>Value</u>
<b>Preferred Securities — (continued)</b>		
<b>Miscellaneous Industries — 1.9%</b>		
13,600	E.I. Du Pont de Nemours and Company, \$4.50 Pfd., Series B .....	\$ 1,167,764*
40,000	Ocean Spray Cranberries, Inc., 6.25% Pfd., 144A**** .....	3,297,600*
26,000	Touch America Holdings, \$6.875 Pfd. ....	—*†
		<u>4,465,364</u>
	<b>Total Preferred Securities</b> (Cost \$218,142,479) .....	<u>234,892,074</u>
<b>Corporate Debt Securities — 1.1%</b>		
<b>Oil and Gas — 0.2%</b>		
15,000	Nexen, Inc., 7.35% Subordinated Notes .....	388,050 <sup>(1)</sup>
		<u>388,050</u>
<b>Utilities — 0.9%</b>		
\$ 1,000,000	Duquesne Light Holdings, 6.25% 08/15/35 .....	985,295
45,000	Northern States Power Company, 8.00% .....	1,180,125
		<u>2,165,420</u>
	<b>Total Corporate Debt Securities</b> (Cost \$2,492,012) .....	<u>2,553,470</u>
<b>Common Stock — 0.8%</b>		
<b>Banking — 0.8%</b>		
110,000	New York Community Bancorp, Inc. ....	1,850,750*
		<u>1,850,750</u>
	<b>Total Common Stock</b> (Cost \$1,917,807) .....	<u>1,850,750</u>

**PORTFOLIO OF INVESTMENTS (Continued)**

**February 28, 2006 (Unaudited)**

<u>Shares/\$ Par</u>	<u>Value</u>
<b>Option Contracts — 0.4%</b>	
250 April Put Options on June U.S. Treasury Bond Futures, Expiring 03/24/06 . . . . .	\$ 515,625†
391 June Put Options on June U.S. Treasury Bond Futures, Expiring 05/26/06 . . . . .	73,313†
884 June Put Options on June U.S. Treasury Bond Futures, Expiring 05/26/06 . . . . .	386,750†
<hr/>	
<b>Total Option Contracts</b>	
(Cost \$1,170,466) . . . . .	<u>975,688</u>
<b>Money Market Fund — 1.3%</b>	
3,266,070 BlackRock Provident Institutional, TempFund . . . . .	3,266,070
<hr/>	
<b>Total Money Market Fund</b>	
(Cost \$3,266,070) . . . . .	<u>3,266,070</u>
<b>Total Investments</b> (Cost \$226,988,834***) . . . . .	100.7% 243,538,052
<b>Other Assets And Liabilities</b> (Net) . . . . .	<u>(0.7)% (1,694,073)</u>
<b>Total Net Assets Available to Common and Preferred Stock</b> . . . . .	<u>100.0%‡ \$ 241,843,979</u>
<b>Money Market Cumulative Preferred™ Stock (MMP®) Redemption Value</b> . . . . .	<u>(80,000,000)</u>
<b>Total Net Assets Available To Common Stock</b> . . . . .	<u>\$ 161,843,979</u>

\* 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. These securities have been determined to be liquid under the guidelines established by the Board of Directors.

(1) Foreign Issuer.

† Non-income producing.

‡ The percentage shown for each investment category is the total value of that category as a percentage of net assets available to Common and Preferred Stock.

**ABBREVIATIONS:**

**REIT** — Real Estate Investment Trust

**Pfd.** — Preferred Securities

**Pvt.** — Private Placement Securities

**STATEMENT OF CHANGES IN NET ASSETS AVAILABLE TO COMMON STOCK<sup>(1)</sup>**  
**For the period from December 1, 2005 through February 28, 2006 (Unaudited)**

	<u>Value</u>
<b>OPERATIONS:</b>	
Net investment income . . . . .	\$ 3,101,350
Net realized gain/(loss) on investments sold during the period . . . . .	525,976
Change in net unrealized appreciation/depreciation of investments held during the period . . . . .	3,085,827
Distributions to Money Market Cumulative Preferred™ Stock Shareholders from net investment income, including changes in accumulated undeclared distributions . . . . .	<u>(705,333)</u>
<b>Net increase in net assets resulting from operations . . . . .</b>	<b>6,007,820</b>
<b>DISTRIBUTIONS:</b>	
Dividends paid from net investment income to Common Stock Shareholders <sup>(2)</sup> . . . . .	<u>(2,820,604)</u>
<b>Total Distributions to Common Stock Shareholders . . . . .</b>	<b>(2,820,604)</b>
<b>FUND SHARE TRANSACTIONS:</b>	
Increase from shares issued under the Dividend Reinvestment and Cash Purchase Plan . . . . .	<u>379,395</u>
<b>Net increase in net assets available to Common Stock resulting from Fund share transactions . . . . .</b>	<b>379,395</b>
<b>NET INCREASE IN NET ASSETS AVAILABLE TO COMMON STOCK FOR THE PERIOD . . . . .</b>	<b><u>\$ 3,566,611</u></b>

**NET ASSETS AVAILABLE TO COMMON STOCK:**

Beginning of period . . . . .	\$ 158,277,368
Net increase in net assets during the period . . . . .	<u>3,566,611</u>
End of period . . . . .	<u>\$ 161,843,979</u>

<sup>(1)</sup> These tables summarize the three months ended February 28, 2006 and should be read in conjunction with the Fund's audited financial statements, including footnotes, in its Annual Report dated November 30, 2005.

<sup>(2)</sup> May include income earned, but not paid out, in prior fiscal year.

**FINANCIAL HIGHLIGHTS<sup>(1)</sup>**

For the period from December 1, 2005 through February 28, 2006 (Unaudited)

For a Common share outstanding throughout the period.

**PER SHARE OPERATING PERFORMANCE:**

Net asset value, beginning of period . . . . . \$ 15.26

**INVESTMENT OPERATIONS:**

Net investment income . . . . . 0.30

Net realized and unrealized gain/(loss) on investments . . . . . 0.35

**DISTRIBUTIONS TO MMP<sup>®</sup>\* SHAREHOLDERS:**

From net investment income . . . . . (0.07)

From net realized capital gains . . . . . —

Total from investment operations . . . . . 0.58

**DISTRIBUTIONS TO COMMON STOCK SHAREHOLDERS:**

From net investment income . . . . . (0.27)

From net realized capital gains . . . . . —

Total distributions to Common Stock Shareholders . . . . . (0.27)

Net asset value, end of period . . . . . \$ 15.57

Market value, end of period . . . . . \$ 16.65

Common shares outstanding, end of period . . . . . 10,396,941

**RATIOS TO AVERAGE NET ASSETS AVAILABLE TO COMMON STOCK SHAREHOLDERS:**

Net investment income † . . . . . 5.99%\*\*

Operating expenses . . . . . 1.51%\*\*

**SUPPLEMENTAL DATA: ††**

Portfolio turnover rate . . . . . 22%\*\*\*

Total net assets available to Common and Preferred Stock, end of period (in 000's) . . . \$ 241,844

Ratio of operating expenses to total average net assets available to  
Common and Preferred Stock . . . . . 1.01%\*\*

<sup>(1)</sup> These tables summarize the three months ended February 28, 2006 and should be read in conjunction with the Fund's audited financial statements, including footnotes, in its Annual Report dated November 30, 2005.

\* Money Market Cumulative Preferred<sup>™</sup> Stock.

\*\* Annualized.

\*\*\* Not Annualized.

† The net investment income ratios reflect income net of operating expenses and payments to MMP<sup>®</sup>\* Shareholders.

†† Information presented under heading Supplemental Data includes MMP<sup>®</sup>\*.

**FINANCIAL HIGHLIGHTS (Continued)**  
**Per Share of Common Stock (Unaudited)**

	<u>Total Dividends Paid</u>	<u>Net Asset Value</u>	<u>NYSE Closing Price</u>	<u>Dividend Reinvestment Price<sup>(1)</sup></u>
December 31, 2005 .....	\$0.0905	\$15.38	\$16.09	\$15.38
January 31, 2006 .....	0.0905	15.43	16.89	16.05
February 28, 2006 .....	0.0905	15.57	16.65	15.82

<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 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.

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

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### **1. Aggregate Information for Federal Income Tax Purposes**

At February 28, 2006, the aggregate cost of securities for federal income tax purposes was \$227,273,792, the aggregate gross unrealized appreciation for all securities in which there is an excess of value over tax cost was \$19,742,322 and the aggregate gross unrealized depreciation for all securities in which there is an excess of tax cost over value was \$3,478,062.

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## 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  
Christopher D. Ryan, CFA  
Vice President  
Laurie C. Lodolo  
Assistant Compliance Officer,  
Assistant Treasurer and  
Assistant Secretary

## 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 —  
PFPC Inc.  
P.O. Box 43027  
Providence, RI 02940-3027  
1-800-331-1710

**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

## Quarterly Report

February 28, 2006

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