

## FLAHERTY & CRUMRINE PREFERRED INCOME FUND

Dear Shareholder:

During the first half of fiscal 2005, the Flaherty & Crumrine Preferred Income Fund performed admirably under challenging conditions for investing. For the first two quarters of fiscal 2005, the Fund produced a total return on net asset value (“NAV”) of **+7.8%**<sup>(1)</sup>. In the three month period ending May 31, 2005, the total return on NAV for the Fund was **+1.9%**<sup>(1)</sup>. As can be seen from the table below, over the long run, the Fund has outpaced the return on the Lipper Domestic Investment Grade Bond Funds by a wide margin.

<b>TOTAL RETURN PER YEAR ON NET ASSET VALUE<sup>(1)</sup> FOR PERIODS ENDING MAY 31, 2005</b>				
	<u>One Year</u>	<u>Five Years</u>	<u>Ten Years</u>	<u>Life of Fund<sup>(2)</sup></u>
Flaherty & Crumrine Preferred Income Fund . . . . .	12.1%	13.0%	9.6%	12.1%
Lipper Domestic Investment Grade Bond Funds <sup>(3)</sup> . . . . .	8.1%	8.3%	7.2%	7.8%

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

Along with Federal Reserve Chairman Alan Greenspan, we share some confusion about the “conundrum” of falling *long-term* interest rates in the face of steady increases in *short-term* rates. In the twelve month period ending May 31, 2005, short-term rates have climbed almost 200 basis points. During the same period, long-term rates have *fallen* over 100 basis points. We discuss some reasons for the flattening yield curve in the Question and Answer (“Q&A”) section that follows, but, suffice it to say, these yield curve shifts are without precedent for this phase of an economic cycle. (For an even more in-depth analysis, we invite you to read the 2<sup>nd</sup> Quarter Review of Economic Conditions on the Fund’s website.)

The flattening yield curve has impacted the Fund in different ways. As we’ve discussed in the past, rising short-term interest rates have the direct and immediate effect of increasing the rate (cost) the Fund must pay on its Money Market Cumulative Preferred™ Stock (“MMP<sup>SM</sup>”) leverage. Falling long-term interest rates contribute to appreciation in the investment portfolio, but also increase the likelihood that some of the higher-yielding securities in the portfolio will be redeemed by the issuer, forcing us to replace them with lower-yielding new issues. These were the main factors behind the dividend reduction in April.

Market conditions will always have a big impact on the dividend rate, and the dividend rate on the Fund can change from time to time. What makes the Fund unusual, however, is the use of strategies which are expected to result in the Fund’s income increasing as long-term interest rates rise significantly, while being relatively resistant to declines in long-term interest rates. Nevertheless, it is important to be realistic about

the dividend. When long-term interest rates are hovering around 4%, as they presently are, the portfolio cannot produce the same level of income as when these rates are at 5 or 6%.

We resolutely avoid predicting interest rates, but it is difficult for us to believe that long-term interest rates can remain this low if the U.S. economy continues to grow at the current pace. If rates do increase, the Fund's hedges should appreciate in value and a portion of those gains could be reinvested in additional income-producing securities. In addition, issuers would be less inclined to call some of their higher-yielding issues, since the cost of refinancing presumably also would go up.

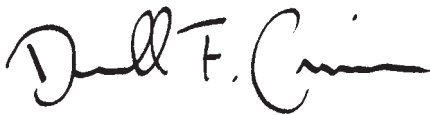
Of course, our investment approach will remain the same regardless of the direction of long-term interest rates. We'll identify companies with stable or improving fundamental credit quality, and invest in the most attractive securities we can find at the best prices obtainable (more on this in the Q&A).

For one of the few times in recent memory, the size of the preferred market is growing by a meaningful amount (more on this in the Q&A). We're still assessing the implications, but one thing is certain — over the long run, this is a very good thing. In our experience, new supply has stimulated preferred market activity and enhanced our ability to add value to the performance of the Fund.

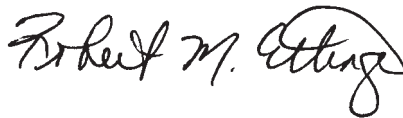
It is basic economic theory that prices will fall to absorb new supply, unless demand also increases. During the past quarter, new supply seemed to outstrip demand by a bit, as, broadly speaking, preferred prices underperformed most other fixed-income market segments. The Fund's preferred holdings, however, bucked the trend and made money during the quarter. Our returns still lagged the performance of long-term U.S. Treasury bonds, but thanks to the "safety-net" hedging strategy, the loss on our hedges was contained and the overall performance was very respectable.

There are a number of interesting developments in the Fund and the preferred market. We've addressed these in greater detail in the following Q&A. We also encourage you to 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. Finally, if you'd like to learn more about specific preferred issues, visit [www.preferredstockguide.com](http://www.preferredstockguide.com), a site created by the Fund's manager, Flaherty & Crumrine.

Sincerely,



Donald F. Crumrine  
Chairman of the Board



Robert M. Ettinger  
President

July 12, 2005

## QUESTIONS & ANSWERS

### 1. How did the Fund's preferred securities perform during the quarter?

Broadly speaking, the Fund's preferred portfolio performed quite well, although to some extent the answer depends on which measure we use for comparing performance. The total return (principal change plus income) on this portion of the Fund was **+3.0%** during the quarter<sup>(1)</sup>. This compares to +5.4% for long-term U.S. Treasury Bonds<sup>(2)</sup>, +1.2% for intermediate-term corporate bonds<sup>(3)</sup> and -0.6% for the S&P 500.

The Fund's preferred portfolio also outperformed the Merrill Lynch Index of DRD Eligible Preferred Stock and the Merrill Lynch Index of Hybrid Preferred Securities. The total returns on these indices were -0.3% and -1.4%, respectively.

As the numbers indicate, it is important to own the right preferreds. The three key components of our investment decision-making process are credit quality, issue terms, and price. We spend most of our time thinking about all three, and then fine-tuning the portfolio to reflect our best judgment.

### 2. What caused the overall preferred market to weaken during the quarter?

The market for preferred securities has been experiencing some growing pains recently. In contrast to the past few years when the size of the preferred market changed very little, during the past few months there has been a steady supply of new issues brought to market. For the market to absorb this supply, yields on preferred securities have risen in relation to other fixed-income investments, and, as a result, the broader market of preferred securities underperformed other segments of the fixed-income market.

### 3. What factors are driving the growth in the preferred market?

One obvious reason is that issuers find the current low interest rate environment attractive. In addition, Moody's Investors Service ("Moody's") has made changes which could induce some companies to issue preferred stock. In the esoteric world of credit rating, the treatment of preferred stock has been somewhat inconsistent. Moody's has attempted to clarify their ratings approach, and several issuers have already responded.

One important aspect of the new approach at Moody's is to treat an issuer's dividend-paying preferred stock (with certain characteristics) less like debt and more like equity than in the past. As a result, some companies may find that substituting debt with preferred can improve the "quality" of their balance sheet and thus lower overall financing costs. Others may issue preferred stock and use the proceeds for a common stock buyback program; substituting preferred stock for common stock, which means the company's income and market value are split among fewer common shares. Preferred stock is also likely to be used more prominently in merger and acquisition financing packages.

We expect the supply of new issues to continue at a steady, manageable rate over the next few quarters, and possibly much longer. Many companies will now be inclined to issue preferred securities as a bigger part of their overall financing strategy.

<sup>(1)</sup> The return here differs from those in the Shareholder letter primarily because it excludes the impact of the Fund's hedging instruments.

<sup>(2)</sup> Lehman Bros. Long U.S. Treasury Index

<sup>(3)</sup> Lehman Bros. Intermediate U.S. Credit Index

#### **4. How did the Fund's hedge perform during the quarter?**

The hedge produced a drag on overall performance during the quarter; however, the put option strategy helped contain the extent of the loss. The yield on long-term U.S. Treasury bonds declined 40 basis points during the period, from 4.72% to 4.32%. The Fund's "safety-net" hedging strategy is designed to mitigate the impact from a move of this magnitude, and during the period the strategy worked as expected.

We are asked from time to time why we continue hedging when interest rates are falling. In hindsight, this seems like a reasonable question, but actually the future direction of interest rates is always a mystery. Consequently, the Fund always employs a hedge against substantial increases in long-term interest rates. This is a core component of the Fund's overall investment strategy and we have no intention of changing it.

#### **5. How does the Fund's manager select the holdings in the portfolio?**

Owning the best issues at the best prices sounds a lot like favoring motherhood and apple pie. To us, however, it means much more. We begin with credit quality. Our analysts dissect the balance sheet and income statements of every company we invest in. As investors in the preferred and debt securities of a company, we think more as lenders than as owners; we're more concerned about stability than growth.

The next step for us is to understand the nuances of each particular security we buy. If we drew a continuum of ways to invest in a company, common stock would be at one end and senior borrowing (e.g. corporate bonds) would be at the other. The area in the middle is occupied by the various types of "hybrid" securities the Fund may invest in. The terms and covenants for these issues can vary quite a bit, and these variances affect the value of the security.

The final step is valuation. We take apart all of the pieces and use a combination of experience and analytic tools to value each part, and then we add them all up. With this price in hand, we simply try to be a good neighbor — if someone wants to sell below our price or buy above our price, we'll make every effort to accommodate them!

#### **6. What is the outlook for the Fund's dividend rate for the remainder of the fiscal year?**

When the Fund reduced the monthly dividend in April, we anticipated that the new rate would be sustainable throughout the fiscal year. While we can make no guarantees, based on our current projections, the Fund is expected to produce sufficient income to continue the dividend at the present rate for the remainder of the fiscal year ending November 30<sup>th</sup>.

#### **7. What is the breakdown between dividends and interest this year?**

Recall that dividends may be taxed at lower rates than other types of income for individual and corporate investors (approximately 15% and 10.5%, respectively). Producing preferentially-taxed dividend income is not a specific objective of the Fund, but such dividends have comprised a large portion of the distributions for many years (78% in 2004 for both individual and corporate investors).

Since some investors may benefit from lower tax rates on dividend income, we realize this is a very important question; unfortunately, the composition of distributions made by the Fund cannot be determined until the end of the fiscal year on November 30<sup>th</sup>. Once the books are closed, we add up dividends and interest earned, short and long-term realized gains (or losses), and subtract the expenses incurred by the Fund. Only then are we able to compute the exact breakdown between qualified dividend income (eligible for lower tax treatment) and other income.

A review of the portfolio holdings in this report shows that as of May 31<sup>st</sup>, 74% of the portfolio's value was in issues that pay qualified dividends. *This is not the percentage of income that is qualified dividends.* The amount of dividend-paying securities held in the portfolio correlates well with the composition of the portfolio's income, but there are a number of additional things (such as realized gains and losses) that factor into the breakdown. Of course, the composition of the portfolio's holdings is sure to change over the balance of the year.

## 8. What is the outlook for the Fund's dividend rate over the longer term?

The further we look into the future, the hazier our crystal ball becomes. Forecasting the dividend beyond periods of six to twelve months is tricky because the projections must be based on assumptions that become increasingly less reliable.

An alternative approach is to remember the primary factors that influence the dividend:

- The income earned on the Fund's investment portfolio;
- The rate the Fund must pay on its leverage; and,
- The cost of the Fund's hedging strategy.

The income earned on the Fund's investment portfolio will be determined primarily by two things — the level of long-term interest rates (typically measured by the yield on 30 year U.S. Treasury bonds), and the relationship of yields on preferred securities to the yield on 30 year U.S. Treasury bonds. Recently, the yield on the 30 year U.S. Treasury bond has been hovering around historically low levels, *and* yields on preferred securities also appear low by historical standards. If these conditions persist for long, we'll start to feel the pinch on our investment income, as issuers accelerate the redemption of our higher-yielding securities.

The rate the Fund pays on its shares of MMP® (the securities used to leverage the Fund) is closely correlated to short-term rates. The much publicized increases in short-term interest rates orchestrated by the Federal Reserve have materially increased the Fund's cost of leverage. In the months leading up to the Fed's policy change last year, the Fund was paying roughly 1% on its leverage. Recently, the rate has been closer to 3%!

The cost of the Fund's hedging strategy is the third major item influencing the dividend rate. We like to use the analogy of an insurance policy — the fund pays premiums to buy "insurance", and we collect if long-term interest rates rise significantly. The cost of the insurance is determined by many things, but a key item is the differential between short- and long-term interest rates. As a general rule, when this differential is large, the cost of hedging is high. Since short-term rates have been rising and long-term rates have been falling, the cost of the Fund's hedges has been falling.

Put it all together and we have a three-legged dividend stool, and each leg can move up or down for different reasons. Trying to forecast changes in one leg is difficult enough, let alone all three. Having said that, we can make some general observations about how the legs of the stool relate to one another. We have already noted that falling long-term interest rates and rising short-term interest rates tend to lower income. At the same time, a flatter yield curve (i.e. a smaller difference between long and short rates) lowers the cost of hedging, potentially improving returns going forward. Although far from perfect, over the long run there is some degree of balance among the three legs of the stool.

As mentioned in the letter, the dividend rate on the Fund does change from time to time. The increases have been larger and more frequent, but cuts have been made occasionally. Market conditions have a big impact on the dividend rate, but over time we believe the Fund's strategy (and our ability to execute it) should deliver more income for our investors.

#### **9. How does the Fund set the dividend?**

The Fund's Board of Directors must declare each and every dividend distribution. The distribution amounts are based upon projections provided to the Board by management, and are based on considerations like those discussed above.

Long ago, the Board adopted the procedure of a "Standing Dividend Resolution", declaring a continuing monthly dividend at a specified rate. Unless the Board acts to change the Standing Dividend Resolution, the Fund will continue to pay the dividend at the prevailing rate. If and when conditions warrant, management will request a meeting of the Board and recommend a different rate, and a new Standing Dividend Resolution may be adopted.

#### **10. Why have long and short rates moved in opposite directions and will this pattern persist going forward?**

Normally during periods of Federal Reserve tightening, the yield curve "flattens" as short rates rise more than long rates. However, in this period of Fed tightening the yield curve has flattened dramatically because long rates have fallen even as short rates have increased – an unprecedented development.

There are a number of reasons why long rates have fallen during this period. Analysts have cited foreign trade policy, shifts in global savings patterns, subdued inflation, and increased demand for long-duration assets. More recently, concerns over slowing economic growth outside the U.S. have pushed global yields lower, particularly in Europe. Finally, technical factors probably contributed to lower yields as well: many investors correctly anticipated Fed tightening, but not the decline in long rates, causing some to cover shorts in long-term bonds at higher prices and lower yields.

The second part of the question, will this pattern persist going forward, is more difficult to answer, but we believe the answer is no. Put simply, if the Fed keeps tightening and bonds keep rallying, soon investors would earn higher yields on less volatile short-term instruments than on more volatile long-term bonds. Foreign investors in particular then might shift investments to short-term instruments as their yields rise above those of current longer-duration holdings. In addition, business investment remains sturdy while corporate profit growth has slowed, suggesting that corporate demand for borrowing and hence bond issuance may increase in coming quarters.

There are many, many pieces to the yield-curve puzzle, but putting it all together, we expect that short-term and long-term rates will move more closely together – and in the same direction! – going forward, which should benefit either our cost of leverage if rates fall or our hedges if rates increase.

Flaherty & Crumrine Preferred Income Fund Incorporated

**PORTFOLIO OVERVIEW**

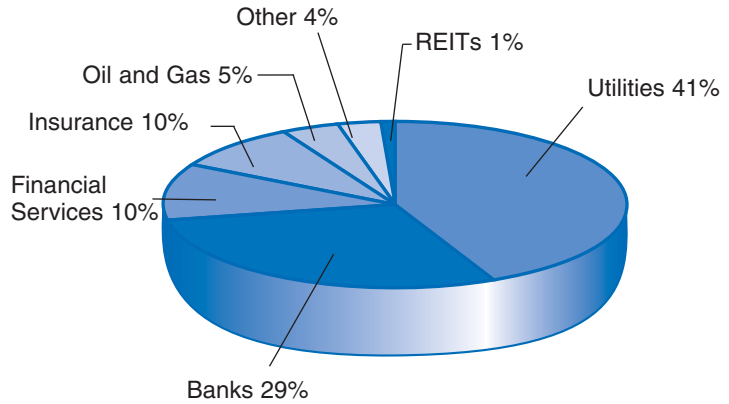
**May 31, 2005 (Unaudited)**

**Fund Statistics on 05/31/05**

Net Asset Value	\$	16.06
Market Price	\$	16.95
Premium		5.54%
Yield on Market Price		6.41%
Common Shares Outstanding		10,324,516

**Industry Categories**

**% of Portfolio**



**Moody's Ratings**

**% of Portfolio**

AAA	2.3%
AA	7.3%
A	24.1%
BBB	40.8%
BB	15.2%
Not Rated	8.5%

Below Investment Grade\* 16.6%

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

**Top 10 Holdings by Issuer**

**% of Portfolio**

Interstate Power	5.3%
Lehman Brothers	4.8%
Citigroup	4.6%
Alabama Power	4.1%
North Fork Bancorporation	3.6%
ABN Amro	3.5%
Zurich RegCaPS	3.4%
Xcel Energy	3.2%
SLM Corporation	2.9%
Cobank	2.9%

**% of Portfolio\*\***

Holdings Generating Qualified Dividend Income (QDI) for Individuals	74%
Holdings Generating Income Eligible for the Corporate Dividend Received Deduction (DRD)	73%

\*\* 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.

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**PORTFOLIO OF INVESTMENTS****May 31, 2005 (Unaudited)**

<u>Shares/\$ Par</u>	<u>Value</u>
<b>Preferred Securities — 94.2%</b>	
<b>Banking — 28.8%</b>	
ABN AMRO North America, Inc.:	
3,625 6.46% Pfd., 144A****	\$ 3,821,149*
4,500 6.59% Pfd., 144A****	4,723,200*
40,000 BAC Capital Trust I, 7.00% Pfd. 12/15/31	1,047,800
400 BancWest Capital I, 9.50% Pfd. 12/01/30	10,312 <sup>(1)</sup>
\$ 750,000 Barnett Capital II, 7.95% 12/01/26 Capital Security	817,129
\$ 1,500,000 BT Preferred Capital Trust II, 7.875% 02/25/27 Capital Security	1,628,407 <sup>(1)</sup>
\$ 250,000 Chase Capital I, 7.67% 12/01/26 Capital Security	268,040
Citigroup, Inc.:	
113,427 5.864% Pfd., Series M	5,935,635*
9,876 6.213% Pfd., Series G	524,811*
26,200 6.231% Pfd., Series H	1,379,299*
65,350 6.365% Pfd., Series F	3,469,431*
Cobank, ACB:	
50,000 7.00% Pfd., 144A****	2,877,500*
75,000 Adj. Rate Pfd., 144A****	4,226,625*
\$ 500,000 Comerica (Imperial) Capital Trust I, 9.98% 12/31/26 Capital Security, Series B	577,770
\$ 2,250,000 First Hawaiian Capital I, 8.343% 07/01/27 Capital Security, Series B	2,501,257 <sup>(1)</sup>
\$ 1,500,000 First Union Capital II, 7.95% 11/15/29 Capital Security	1,938,637
\$ 906,000 First Union Institutional Capital I, 8.04% 12/01/26 Capital Security	984,922
\$ 1,820,000 First Union Institutional Capital II, 7.85% 01/01/27 Capital Security	1,976,866
First Republic Bank:	
200,000 6.25% Pfd.	5,228,000*
5,000 6.70% Pfd.	131,400*
1,800 First Tennessee Bank, Adj. Rate Pfd., 144A****	1,782,000*
\$ 7,820,000 GreenPoint Capital Trust I, 9.10% 06/01/27 Capital Security	8,805,046
\$ 2,500,000 HBOS Capital Funding LP, 6.85% Pfd.	2,556,625 <sup>(1)</sup>
120,026 HSBC USA, Inc., Adj Rate Pfd., Series F	2,961,642*
36,455 J.P. Morgan Chase & Co., 6.625% Pfd., Series H	1,879,620*
\$ 270,000 Keycorp Institutional Capital B, 8.25% 12/15/26 Capital Security	294,978
\$ 674,000 NB Capital Trust II, 7.83% 12/15/26 Capital Security	733,356
\$ 1,700,000 RBS Capital Trust B, 6.80% Pfd.	1,732,461** <sup>(1)</sup>
16,500 Regions Financial Trust I, 8.00% Pfd.	428,505
\$ 2,635,000 Republic New York Capital II, 7.53% 12/04/26 Capital Security	2,836,683 <sup>(1)</sup>
10 Roslyn Real Estate, 8.95% Pfd., Pvt., Series C, 144A****	1,116,041
\$ 1,200,000 Wachovia Capital Trust V, 7.965% 06/01/27 Capital Security, 144A****	1,322,526
7,500 Wachovia Preferred Funding, 7.25% Pfd., Series A	217,013
	<b>70,734,686</b>

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



Flaherty & Crumrine Preferred Income Fund Incorporated  
**PORTFOLIO OF INVESTMENTS (Continued)**  
**May 31, 2005 (Unaudited)**

<u>Shares/\$ Par</u>		<u>Value</u>
<b>Preferred Securities — (continued)</b>		
<b>Financial Services — 9.5%</b>		
60,000	Fannie Mae, 4.75% Pfd., Series M .....	\$ 2,482,500*
	Freddie Mac:	
6,975	5.00% Pfd., Series F .....	306,447*
28,350	5.30% Pfd .....	1,320,259*
	Lehman Brothers Holdings, Inc.:	
68,280	5.67% Pfd., Series D .....	3,397,954*
154,475	5.94% Pfd., Series C .....	7,948,511*
15,000	6.50% Pfd., Series F .....	392,925*
19,700	National Rural Utility CFC, 5.95% Pfd. 02/15/45 .....	478,316
123,805	SLM Corporation, 6.97% Pfd., Series A .....	7,105,169*
		<u>23,432,081</u>
<b>Insurance — 9.4%</b>		
40,000	ACE Ltd., 7.80% Pfd., Series C .....	1,062,200** <sup>(1)</sup>
40,000	Aegon NV, 6.375% Pfd. ....	1,001,200** <sup>(1)</sup>
\$ 2,000,000	AON Capital Trust A, 8.205% 01/01/27 Capital Security .....	2,343,300
21,000	Everest Re Capital Trust II, 6.20% Pfd. Series B .....	501,375 <sup>(1)</sup>
\$ 5,150,000	MMI Capital Trust I, 7.625% 12/15/27 Capital Security, Series B .....	5,990,248
	Premium Assets, Series A:	
10	Zurich RegCaPS Money Market Pfd., Pvt. ....	1,013,750*
18	Zurich RegCaPS Variable Inverse Pfd., Pvt. ....	2,057,326*
\$ 4,000,000	Provident Financing Trust I, 7.405% 03/15/38 Capital Security .....	3,818,780
7,000	St. Paul Capital Trust I, 7.60% Pfd. ....	182,630
	Zurich RegCaPS Funding Trust:	
2,050	6.01% Pfd., 144A**** .....	2,069,403*
2,950	6.58% Pfd., 144A**** .....	3,112,943*
		<u>23,153,155</u>
<b>Utilities — 38.9%</b>		
	Alabama Power Company:	
300	4.52% Pfd. ....	28,597*
5,734	4.72% Pfd. ....	570,791*
89,100	5.20% Pfd. ....	2,284,524*
275,000	5.30% Pfd. ....	7,118,375*
10,000	Baltimore Gas & Electric Company, 6.70% Pfd., Series 1993 .....	1,044,200*

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

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**PORTFOLIO OF INVESTMENTS (Continued)****May 31, 2005 (Unaudited)**

<u>Shares/\$ Par</u>		<u>Value</u>
<b>Preferred Securities — (continued)</b>		
<b>Utilities — (continued)</b>		
Central Hudson Gas & Electric Corporation:		
5,000	4.35% Pfd., Series D, Pvt. ....	\$ 461,500*
900	4.96% Pfd., Series E, Pvt. ....	90,940*
10,000	Central Illinois Light Company, 4.64% Pfd. ....	1,011,600*
11,000	Central Illinois Public Service Corporation, 4.90% Pfd. ....	1,137,950*
16,679	Central Vermont Public Service Corporation, 8.30% Sinking Fund Pfd., Pvt. ....	1,734,199*
Connecticut Light & Power Company:		
2,124	4.50% Pfd., Pvt. ....	90,684*
34,300	5.28% Pfd., Series 1967 ....	1,655,661*
1,905	6.56% Pfd., Series 1968 ....	98,517*
15,778	\$3.24 Pfd. ....	826,373*
2,100	Consolidated Edison Company of New York, 4.65% Pfd., Series C ....	205,243*
2,886	Dayton Power and Light Company, 3.90% Pfd., Series C ....	223,939*
Duke Energy Corporation:		
3,000	4.50% Pfd., Series C, Pvt. ....	287,085*
519	7.04% Pfd., Series Y ....	53,556*
30,762	7.85% Pfd., Series S ....	3,188,020*
Duquesne Light Company:		
7,675	4.10% Pfd. ....	301,052*
9,190	4.15% Pfd. ....	364,935*
910	4.20% Pfd. ....	36,568*
40,575	6.50% Pfd. ....	2,186,992*
5,490	\$2.10 Pfd., Series A ....	220,616*
5,000	Energy East Capital Trust I, 8.25% Pfd. ....	130,850
Entergy Arkansas, Inc.:		
5,574	7.32% Pfd. ....	581,786*
11,350	7.40% Pfd. ....	1,180,684*
5,030	7.80% Pfd. ....	526,012*
3,822	7.88% Pfd. ....	398,807*
30,266	\$1.96 Pfd. ....	757,407*
4,555	Entergy Gulf States, Inc., 7.56% Pfd. ....	463,676*
Entergy Louisiana, Inc.:		
260	7.84% Pfd. ....	27,182*
106,538	8.00% Pfd., Series 92 ....	2,686,888*
Entergy Mississippi, Inc.:		
5,000	4.92% Pfd. ....	455,950*
8,600	7.44% Pfd. ....	891,003*
10,800	Enterprise Capital Trust I, 7.44% Pfd., Series A ....	274,698

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Flaherty & Crumrine Preferred Income Fund Incorporated  
**PORTFOLIO OF INVESTMENTS (Continued)**  
**May 31, 2005 (Unaudited)**

<u>Shares/\$ Par</u>		<u>Value</u>
<b>Preferred Securities — (continued)</b>		
<b>Utilities — (continued)</b>		
	Florida Power Company:	
17,769	4.58% Pfd. ....	\$ 1,752,379*
5,157	4.60% Pfd. ....	508,042*
18,535	4.75% Pfd. ....	1,885,566*
50,000	Georgia Power Capital Trust V, 7.125% Pfd. ....	1,316,250
2,010	Great Plains Energy, Inc., 4.50% Pfd. ....	174,920*
\$ 3,500,000	Houston Light & Power, Capital Trust II, 8.257%, 02/01/37 Capital Security .....	3,832,150
32,650	Indianapolis Power & Light Company, 5.65% Pfd. ....	3,170,478*
384,000	Interstate Power & Light Company, 8.375% Pfd., Series B .....	12,946,560*
14,250	Narragansett Electric Company, 4.64% Pfd. ....	709,365*
	Northern Indiana Public Service Company:	
3,905	7.44% Pfd. ....	399,150*
7,465	Adj. Rate Pfd., Series A .....	379,782*
6,170	Ohio Edison Company, 4.44% Pfd. ....	533,983*
	Pacific Enterprises:	
27,430	\$4.50 Pfd. ....	2,548,247*
10,000	\$4.75 Pfd., Series 53 .....	980,550*
	Pacific Gas & Electric Co.:	
41,500	5.00% Pfd., Series D .....	941,427*
45,500	5.00% Pfd., Series E .....	1,032,167*
	PacifiCorp:	
936	5.40% Pfd. ....	94,194*
1,225	\$4.56 Pfd. ....	113,735*
14,542	\$4.72 Pfd. ....	1,397,559*
14,388	\$7.48 Sinking Fund Pfd. ....	1,531,962*
5,000	PECO Energy Company, \$4.40 Pfd., Series C .....	404,600*
11,194	Portland General Electric, 7.75% Sinking Fund Pfd. ....	1,147,721*
5,000	PPL Electric Utilities Corporation, 6.75% Pfd. ....	522,650*
10,000	Public Service Company of New Mexico, 4.58% Pfd., Series 1965 .....	841,900*
	San Diego Gas & Electric Company:	
1,200	4.40% Pfd. ....	22,842*
700	4.50% Pfd. ....	13,629*
67,000	\$1.70 Pfd. ....	1,746,690*
13,100	Savannah Electric & Power Company, 6.00% Pfd. ....	363,329*
	South Carolina Electric & Gas Company:	
25,373	5.125% Purchase Fund Pfd., Pvt. ....	1,305,441*
6,703	6.00% Purchase Fund Pfd., Pvt. ....	341,585*

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

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**PORTFOLIO OF INVESTMENTS (Continued)****May 31, 2005 (Unaudited)**

<u>Shares/\$ Par</u>		<u>Value</u>
<b>Preferred Securities — (continued)</b>		
<b>Utilities — (continued)</b>		
	Southern California Edison:	
54,100	4.08% Pfd. ....	\$ 1,077,943*
13,000	Adj. Rate Pfd. ....	1,324,375*
75,000	Southern Union Company, 7.55% Pfd. ....	2,085,000*
\$ 750,000	TXU Electric Capital V, 8.175% 01/30/37 Capital Security ....	802,241
	TXU US Holdings Company:	
10,000	\$4.00 Pfd., Series TES ....	728,200*
5,700	\$4.00 Pfd., Series TPL ....	415,074*
1,000	\$4.84 Pfd. ....	88,110*
	Union Electric Company:	
14,150	4.56% Pfd. ....	1,398,445*
4,000	\$7.64 Pfd. ....	417,500*
12,500	Virginia Electric & Power Company, \$7.05 Pfd. ....	1,289,188*
	Wisconsin Power & Light Company:	
1,220	4.50% Pfd. ....	121,018*
394	4.80% Pfd. ....	41,232*
13,000	6.20% Pfd. ....	1,333,995*
	Xcel Energy, Inc.:	
16,030	\$4.08 Pfd., Series B ....	1,342,272*
26,200	\$4.10 Pfd., Series C ....	2,204,599*
22,000	\$4.11 Pfd., Series D ....	1,855,700*
17,750	\$4.16 Pfd., Series E ....	1,515,406*
10,000	\$4.56 Pfd., Series G ....	935,850*
		<u>95,531,861</u>
<b>Oil and Gas — 4.5%</b>		
17,200	Anadarko Petroleum Corporation, 5.46% Pfd. ....	1,786,220*
7,000	Apache Corporation, 5.68% Pfd., Series B ....	730,275*
8,000	Devon Energy Corporation, 6.49% Pfd., Series A ....	857,200*
5,985	EOG Resources, Inc., 7.195% Pfd., Series B ....	6,489,984*
10,000	Lasmo America Limited, 8.15% Pfd., 144A**** ....	1,158,550*(1)
		<u>11,022,229</u>

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

Flaherty & Crumrine Preferred Income Fund Incorporated  
**PORTFOLIO OF INVESTMENTS (Continued)**  
**May 31, 2005 (Unaudited)**

<u>Shares/\$ Par</u>		<u>Value</u>
<b>Preferred Securities — (continued)</b>		
<b>Real Estate Investment Trust (REIT) — 1.3%</b>		
20,000	PS Business Parks, Inc., 7.20% Pfd., REIT, Series M .....	\$ 497,900
	Public Storage, Inc.:	
6,500	6.18% Pfd., REIT, Series D .....	154,407
22,500	6.75% Pfd., REIT, Series E .....	566,438
40,000	Realty Income Corporation, 7.375%, Pfd., REIT, Series D .....	1,039,600
40,000	Regency Centers Corporation, 7.25% Pfd., REIT .....	1,019,800
		<u>3,278,145</u>
<b>Miscellaneous Industries — 1.8%</b>		
13,600	E.I. Du Pont de Nemours and Company, \$4.50 Pfd., Series B .....	1,325,592*
36,200	Farmland Industries, Inc., 8.00% Pfd., 144A**** .....	18,100*†
33,250	Ocean Spray Cranberries, Inc., 6.25% Pfd., 144A**** .....	3,118,019*
26,000	Touch America Holdings, \$6.875 Pfd. ....	—*†
		<u>4,461,711</u>
	<b>Total Preferred Securities</b> (Cost \$209,026,365) .....	<u>231,613,868</u>
<b>Corporate Debt Securities — 1.1%</b>		
<b>Utilities — 1.1%</b>		
45,000	Northern States Power Company, 8.00% .....	1,213,650
\$ 1,500,000	Potomac Electric Power Company, 5.40% 06/01/35, 1 <sup>st</sup> Mortgage .....	1,507,800
		<u>2,721,450</u>
	<b>Total Corporate Debt Securities</b> (Cost \$2,602,065) .....	<u>2,721,450</u>
<b>Common Stocks and Convertible Security — 2.3%</b>		
<b>Banking — 0.4%</b>		
50,000	New York Community Bancorp, Inc. ....	913,750*
		<u>913,750</u>
<b>Insurance — 0.7%</b>		
50,000	UnumProvident Corporation, 8.25% Mandatory Convertible, 05/16/06 .....	1,803,750
		<u>1,803,750</u>

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

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**PORTFOLIO OF INVESTMENTS (Continued)****May 31, 2005 (Unaudited)**

<u>Shares/\$ Par</u>		<u>Value</u>
<b>Common Stocks and Convertible Security — (continued)</b>		
<b>Utilities — 1.2%</b>		
107,500	Duke Energy Corporation .....	\$ 2,964,313*
		<u>2,964,313</u>
	<b>Total Common Stocks and Convertible Security</b> (Cost \$5,062,209) .....	<u>5,681,813</u>
<b>Option Contracts — 0.2%</b>		
1,425	September Put Options on September U.S. Treasury Bond Futures, Expiring 08/26/05 .....	426,172†
	<b>Total Option Contracts</b> (Cost \$1,271,006) .....	<u>426,172</u>
<b>Money Market Fund — 2.4%</b>		
5,756,277	BlackRock Provident Institutional, TempFund .....	5,756,277
	<b>Total Money Market Fund</b> (Cost \$5,756,277) .....	<u>5,756,277</u>
	<b>Total Investments</b> (Cost \$223,717,922***) .....	100.2% 246,199,580
	<b>Other Assets And Liabilities</b> (Net) .....	<u>(0.2)% (384,122)</u>
	<b>Total Net Assets Available to Common and Preferred Stock</b> .....	<u>100.0%‡ \$ 245,815,458</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>\$ 165,815,458</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.

(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

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

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**STATEMENT OF ASSETS AND LIABILITIES****May 31, 2005 (Unaudited)****ASSETS:**

Investments, at value (Cost \$223,717,922) (See accompanying Portfolio of Investments) .....	\$246,199,580
Receivable for Investments sold .....	504,979
Dividends and interest receivable .....	2,037,522
Prepaid expenses .....	<u>187,206</u>
Total Assets .....	248,929,287

**LIABILITIES:**

Payable for Investments purchased .....	\$2,648,480
Dividends payable to Common Shareholders .....	129,494
Investment advisory fee payable .....	114,577
Administration, Transfer Agent and Custodian fees and expenses payable .....	24,712
Professional fees payable .....	34,244
Directors' fees payable .....	4,019
Accrued expenses and other payables .....	32,892
Accumulated undeclared distributions to Money Market Cumulative Preferred™ Stock Shareholders .....	<u>125,411</u>
Total Liabilities .....	<u>3,113,829</u>

<b>Money Market Cumulative Preferred™ Stock (800 shares outstanding) redemption value .....</b>	<u>80,000,000</u>
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**NET ASSETS AVAILABLE TO COMMON STOCK .....** \$ 165,815,458

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

Undistributed net investment income .....	\$ 185,434
Accumulated net realized loss on investments sold .....	(5,679,880)
Unrealized appreciation of investments .....	22,481,658
Par value of Common Stock .....	103,245
Paid-in capital in excess of par value of Common Stock .....	<u>148,725,001</u>
Total Net Assets Available to Common Stock .....	<u><u>\$165,815,458</u></u>

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

Common Stock (10,324,516 shares outstanding) .....	<u><u>\$ 16.06</u></u>
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The accompanying notes are an integral part of the financial statements.

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**STATEMENT OF OPERATIONS****For the Six Months Ended May 31, 2005 (Unaudited)****INVESTMENT INCOME:**

Dividends†† . . . . .		\$ 5,979,785
Interest . . . . .		<u>1,534,704</u>
Total Investment Income . . . . .		7,514,489

**EXPENSES:**

Investment advisory fee . . . . .	\$672,725	
Administrator's fee . . . . .	111,416	
Money Market Cumulative Preferred™ Stock broker commissions and auction agent fees . . . . .	113,617	
Professional fees . . . . .	68,323	
Insurance expense . . . . .	85,341	
Transfer agent fees and expenses . . . . .	43,174	
Directors' fees and expenses . . . . .	39,130	
Custodian fees and expenses . . . . .	13,694	
Chief Compliance Officer fees and expenses . . . . .	19,694	
Other . . . . .	<u>65,102</u>	
Total Expenses . . . . .		<u>1,232,216</u>

<b>NET INVESTMENT INCOME</b> . . . . .		<u>6,282,273</u>
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**REALIZED AND UNREALIZED GAIN ON INVESTMENTS:**

Net realized gain on investments sold during the period . . . . .		4,394,050
Change in net unrealized appreciation of investments held during the period . . . . .		<u>2,526,438</u>

<b>NET REALIZED AND UNREALIZED GAIN ON INVESTMENTS</b> . . . . .		<u>6,920,488</u>
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**DISTRIBUTIONS TO MONEY MARKET CUMULATIVE PREFERRED™ STOCK SHAREHOLDERS:**

From net investment income (including changes in accumulated undeclared distributions) . . . . .		<u>(972,364)</u>
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<b>NET INCREASE IN NET ASSETS TO COMMON STOCK RESULTING FROM OPERATIONS</b> . . . . .		<u>\$ 12,230,397</u>
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†† 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.

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



Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**STATEMENTS OF CHANGES IN NET ASSETS AVAILABLE TO COMMON STOCK<sup>(1)</sup>**

	Six Months Ended May 31, 2005 (Unaudited)	Year Ended November 30, 2004
<b>OPERATIONS:</b>		
Net investment income . . . . .	\$ 6,282,273	\$ 12,687,506
Net realized gain/(loss) on investments sold during the period . . . . .	4,394,050	(2,229,089)
Change in net unrealized appreciation/(depreciation) of investments held during the period . . . . .	2,526,438	(1,053,489)
Distributions to Money Market Cumulative Preferred™ Stock Shareholders from net investment income, including changes in accumulated undeclared distributions . . . . .	<u>(972,364)</u>	<u>(1,159,026)</u>
<b>Net increase in net assets resulting from operations . . . . .</b>	<b>12,230,397</b>	<b>8,245,902</b>
<b>DISTRIBUTIONS:</b>		
Dividends paid from net investment income to Common Stock Shareholders <sup>(1)</sup> . . . . .	<u>(6,447,949)</u>	<u>(12,055,522)</u>
<b>Total Distributions to Common Stock Shareholders . . . . .</b>	<b>(6,447,949)</b>	<b>(12,055,522)</b>
<b>FUND SHARE TRANSACTIONS:</b>		
Increase from Common Stock transactions . . . . .	<u>932,008</u>	<u>1,986,451</u>
<b>Net increase in net assets available to Common Stock resulting from Fund share transactions . . . . .</b>	<b>932,008</b>	<b>1,986,451</b>
<b>NET INCREASE/(DECREASE) IN NET ASSETS AVAILABLE TO COMMON STOCK FOR THE PERIOD . . . . .</b>	<b><u>\$ 6,714,456</u></b>	<b><u>\$ (1,823,169)</u></b>
<b>NET ASSETS AVAILABLE TO COMMON STOCK:</b>		
Beginning of period . . . . .	\$159,101,002	\$160,924,171
Net increase/(decrease) during the period . . . . .	<u>6,714,456</u>	<u>(1,823,169)</u>
End of period (including undistributed net investment income of \$185,434 and \$1,323,474, respectively) . . . . .	<u>\$165,815,458</u>	<u>\$159,101,002</u>

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

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

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**FINANCIAL HIGHLIGHTS****For a Common share outstanding throughout each period.**

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

	Six Months Ended May 31, 2005 (Unaudited)	Year Ended November 30,				
		2004	2003	2002	2001	2000
<b>PER SHARE OPERATING PERFORMANCE:</b>						
Net asset value, beginning of period .....	\$ 15.49	\$ 15.85	\$ 13.63	\$ 14.62	\$ 13.41	\$ 14.41
<b>INVESTMENT OPERATIONS:</b>						
Net investment income .....	0.61	1.24	1.28	1.29	1.23	1.32
Net realized and unrealized gain/(loss) on investments .....	0.68	(0.31)	2.27	(1.01)	1.19	(0.56)
<b>DISTRIBUTIONS TO MMP<sup>**</sup> SHAREHOLDERS:</b>						
From net investment income .....	(0.09)	(0.11)	(0.10)	(0.12)	(0.23)	(0.29)
From net realized capital gains .....	—	—	—	—	—	(0.01)
Total from investment operations .....	<u>1.20</u>	<u>0.82</u>	<u>3.45</u>	<u>0.16</u>	<u>2.19</u>	<u>0.46</u>
Cost of Issuance of Additional MMP <sup>**</sup> (Note 6) .....	—	—	—	(0.05)	—	—
<b>DISTRIBUTIONS TO COMMON SHAREHOLDERS:</b>						
From net investment income .....	(0.63)	(1.18)	(1.23)	(1.10)	(0.98)	(1.04)
From net realized capital gains .....	—	—	—	—	—	(0.42)
Total distributions to Common Shareholders .....	<u>(0.63)</u>	<u>(1.18)</u>	<u>(1.23)</u>	<u>(1.10)</u>	<u>(0.98)</u>	<u>(1.46)</u>
Net asset value, end of period .....	<u>\$ 16.06</u>	<u>\$ 15.49</u>	<u>\$ 15.85</u>	<u>\$ 13.63</u>	<u>\$ 14.62</u>	<u>\$ 13.41</u>
Market value, end of period .....	<u>\$ 16.95</u>	<u>\$ 17.42</u>	<u>\$ 17.65</u>	<u>\$ 15.00</u>	<u>\$ 14.47</u>	<u>\$ 12.13</u>
Total investment return based on net asset value** .....	<u>7.60%****</u>	<u>4.73%</u>	<u>25.87%</u>	<u>0.58%</u>	<u>17.01%</u>	<u>4.55%</u>
Total investment return based on market value** .....	<u>0.98%****</u>	<u>5.76%</u>	<u>27.35%</u>	<u>11.84%</u>	<u>28.02%</u>	<u>6.88%</u>
<b>RATIOS TO AVERAGE NET ASSETS AVAILABLE</b>						
<b>TO COMMON STOCK SHAREHOLDERS:</b>						
Total net assets, end of period (in 000's) .....	\$165,815	\$159,101	\$160,924	\$136,756	\$144,650	\$131,892
Operating expenses .....	1.50%***	1.48%	1.51%	1.48%	1.42%	1.41%
Net investment income † .....	6.45%***	7.14%	7.84%	8.32%	7.21%	7.58%
<b>SUPPLEMENTAL DATA:††</b>						
Portfolio turnover rate .....	21%****	27%	28%	30%	39%	66%
Total net assets available to Common and Preferred Stock, end of period (in 000's) .....	\$245,815	\$239,101	\$240,992	\$216,974	\$202,412	\$189,983
Ratio of operating expenses to total average net assets available to Common and Preferred Stock .....	1.01%***	0.99%	0.99%	0.99%	1.00%	0.98%

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

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

\*\*\* 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>.

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

Flaherty & Crumrine Preferred Income Fund Incorporated  
**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 (1)</u>
December 31, 2004 - <b>Extra</b> .....	\$0.0650	\$15.89	\$18.25	\$17.34
December 31, 2004. ....	0.0950	15.89	18.25	17.34
January 31, 2005 .....	0.0950	16.12	18.30	17.39
February 28, 2005. ....	0.0950	16.03	18.77	17.83
March 31, 2005. ....	0.0950	15.93	15.74	15.93
April 30, 2005 .....	0.0905	16.03	16.75	16.03
May 31, 2005 .....	0.0905	16.06	16.95	16.10

(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.

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

Flaherty & Crumrine Preferred Income Fund Incorporated

## **FINANCIAL HIGHLIGHTS (Continued)**

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

<u>Date</u>	<u>Total Shares Outstanding (1)</u>	<u>Asset Coverage Per Share (2)</u>	<u>Involuntary Liquidating Preference Per Share (3)</u>	<u>Average Market Value Per Share (1) &amp; (3)</u>
05/31/05*	800	\$307,426	\$100,000	\$100,000
11/30/04	800	299,078	100,000	100,000
11/30/03	800	301,240	100,000	100,000
11/30/02	800	271,218	100,000	100,000
11/30/01	575	352,021	100,000	100,000
11/30/00	575	330,404	100,000	100,000
11/30/99	575	347,588	100,000	100,000
11/30/98	575	381,562	100,000	100,000

(1) See note 6. The Fund issued 225 shares of additional MMP® on June 4, 2002.

(2) Calculated by subtracting the Fund's total liabilities (excluding the MMP®) from the Fund's total assets and dividing that amount by the number of MMP® shares outstanding.

(3) Excludes accumulated undeclared dividends.

\* Unaudited.

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

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**NOTES TO FINANCIAL STATEMENTS (Unaudited)****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 financial statements is in conformity with accounting principles generally accepted in the United States of America 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. It is determined by dividing the value of the Fund's net assets attributable 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 the outstanding Money Market Cumulative Preferred™ Stock ("MMP").

Securities listed on a national securities exchange are valued on the basis of the last sale on such exchange on the day of valuation, except as described hereafter. In the absence of sales of listed securities and with respect to (a) securities for which the most recent sale prices are not deemed to represent fair market value and (b) unlisted securities (other than money market instruments), securities are valued at the mean between the closing bid and asked prices when quoted prices for investments are readily available. Investments in over-the-counter derivative instruments, such as interest rate swaps and options thereon ("swaptions"), are valued at the prices obtained from the broker/dealer or bank that is the counterparty to such instrument, subject to comparison of such valuation with a valuation obtained from a broker/dealer or bank that is not a counterparty to the particular derivative instrument. Investments for which market quotations are not readily available or for which management determines that the prices are not reflective of current market conditions are valued at fair value as determined in good faith by or under the direction of the Board of Directors of the Fund, including reference to valuations of other securities which are comparable in quality, maturity and type. Investments in money market instruments, which mature in 60 days or less, are valued at amortized cost. Investments in money market funds are valued at the net asset value of such funds.

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

Flaherty & Crumrine Preferred Income Fund Incorporated

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

also amortizes premiums and accretes discounts on those fixed income securities, including capital securities and bonds, which trade and are quoted on an “accrued income” basis.

*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. The risks associated with purchasing options and the maximum loss the Fund would incur are limited to the purchase price originally paid.

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.

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.

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

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

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

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

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

Income and capital gain distributions are determined and characterized in accordance with income tax regulations which may differ from generally accepted accounting principles. These differences are primarily due to (1) differing treatments of income and gains on various investment securities held by the Fund, including timing differences, (2) the attribution of expenses against certain components of taxable investment income, and (3) federal regulations requiring 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 "accrued 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 MMP® shareholders, during 2005 and 2004 was as follows:

	<u>Distributions paid in fiscal year 2005</u>		<u>Distributions paid in fiscal year 2004</u>	
	<u>Ordinary Income</u>	<u>Long-Term Capital Gains</u>	<u>Ordinary Income</u>	<u>Long-Term Capital Gains</u>
Common	N/A	N/A	\$12,055,522	\$0
Preferred	N/A	N/A	\$1,159,026	\$0

As of November 30, 2004, the components of distributable earnings (i.e., ordinary income and capital gain/loss) available to Common and Preferred 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>
\$(8,723,351)	\$1,728,652	\$0	\$18,604,640

At November 30, 2004, the composition of the Fund's \$8,723,351 accumulated realized capital losses was \$4,444,626, \$513,821, \$755,160 and \$3,009,744 in 2000, 2001, 2002 and 2004, respectively. These losses may be carried forward and offset against any future capital gains through 2008, 2009, 2010 and 2012, respectively.

*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 paid \$37,828 of Federal excise taxes attributable to calendar year 2004 in March of 2005.

Flaherty & Crumrine Preferred Income Fund Incorporated

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

### **3. 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 net assets available to Common and Preferred Stock up to \$100 million and 0.50% of the value of the Fund's average monthly total net assets available to Common and Preferred Stock in excess of \$100 million.

PFPC Inc., a member of the PNC Financial Services Group, Inc. ("PNC Financial Services"), serves as the Fund's Administrator. As Administrator, PFPC Inc. calculates the net asset value of the Fund's shares attributable to Common and Preferred Stock and generally assists in all aspects of the Fund's administration and operation. As compensation for PFPC Inc.'s services as Administrator, the Fund pays PFPC Inc. a monthly fee at an annual rate of 0.10% of the first \$200 million of the Fund's average 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.

PFPC Inc. also serves as the Fund's Common Stock dividend-paying agent and registrar (Transfer Agent). As compensation for PFPC Inc.'s services, the Fund pays PFPC Inc. 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, 0.01% of the next \$350 million of the Fund's average weekly net assets attributable to Common Stock, 0.005% of the next \$500 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 \$1 billion, plus certain out of pocket expenses. For the purpose of calculating such fee, the Fund's average weekly net assets attributable to Common Stock will be deemed to be the average weekly value of the Fund's total assets minus the sum of the Fund's liabilities, and accumulated dividends, if any, on Preferred Stock. For this calculation, the Fund's liabilities are deemed to include the aggregate liquidation preference of any outstanding Fund preferred shares.

PFPC Trust Company ("PFPC Trust") serves as the Fund's custodian. PFPC Trust is an indirect subsidiary of PNC Financial Services. As compensation for PFPC Trust's services as custodian, the Fund pays PFPC Trust a monthly fee at the annual rate of 0.010% 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 \$500 for each in-person meeting of the Board of Directors or any committee and \$150 for each telephone meeting. The Audit Committee Chairman receives an additional annual fee of \$2,500. The Fund also reimburses all Directors for travel and out-of-pocket expenses incurred in connection with such meetings.



Flaherty &amp; Crumrine Preferred Income Fund Incorporated

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

On July 23, 2004, the Board of Directors designated Peter C. Stimes as Chief Compliance Officer ("CCO") of the Fund. The Fund currently pays Mr. Stimes, in his capacity as CCO, \$37,500 per annum and reimburses his out-of-pocket expenses incurred in connection with his role as CCO.

**4. Purchases and Sales of Securities**

For the six months ended May 31, 2005, the cost of purchases and proceeds from sales of securities excluding short-term investments, aggregated \$49,644,905 and \$55,373,070, respectively.

At May 31, 2005, the aggregate cost of securities for federal income tax purposes was \$222,367,343, the aggregate gross unrealized appreciation for all securities in which there is an excess of value over tax cost was \$29,370,145 and the aggregate gross unrealized depreciation for all securities in which there is an excess of tax cost over value was \$5,537,908.

**5. Common Stock**

At May 31, 2005, 240,000,000 shares of \$0.01 par value Common Stock were authorized.

Common Stock Transactions were as follows:

	<u>Six Months Ended</u> <u>5/31/05</u>		<u>Year Ended</u> <u>11/30/04</u>	
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>
Issued as reinvestment of dividends under the Dividend Reinvestment and Cash Purchase Plan . . . . .	<u>55,212</u>	<u>\$ 932,008</u>	<u>116,588</u>	<u>\$ 1,986,451</u>

**6. Money Market Cumulative Preferred™ Stock (MMP®)**

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

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

If the Fund allocates any net gains or income ineligible for the Dividends Received Deduction to shares of the MMP®, the Fund is required to make additional distributions to MMP® Shareholders or to pay a higher dividend rate in amounts needed to provide a return, net of tax, equal to the return had such originally paid distributions been eligible for the Dividends Received Deduction.

Flaherty & Crumrine Preferred Income Fund Incorporated

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

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

At May 31, 2005, 800 shares of MMP® were outstanding at the annualized rate of 3.150%. The dividend rate, as set by the auction process, is generally expected to vary with short-term interest rates. These rates may vary in a manner unrelated to the income received on the Fund's assets, which could have either a beneficial or detrimental impact on net investment income and gains available to Common Stock Shareholders. While the Fund expects to structure its portfolio holdings and hedging transactions to lessen such risks to Common Stock Shareholders, there can be no assurance that such results will be attained.

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

The Fund invests primarily in traditional DRD-eligible preferred securities (i.e., adjustable and fixed rate preferred and preference stocks) and similar hybrid (i.e., fully taxable) preferred securities. Under normal market conditions, at least 80% of the value of the Fund's net assets will be invested in preferred securities. Also, under normal market conditions, the Fund invests at least 25% of its assets in securities issued by utilities and at least 25% of its assets in securities issued by companies in the banking industry. The Fund's portfolio may therefore be subject to greater risk and market fluctuation than a portfolio of securities representing a broader range of investment alternatives. These risks could adversely affect the ability and inclination of companies in these industries to declare and pay dividends or interest and the ability of holders of securities of such companies to realize any value from the assets of the issuer upon liquidation or bankruptcy.

The Fund may invest up to 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 judged to be comparable in quality, in either 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 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.

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**NOTES TO FINANCIAL STATEMENTS (Unaudited) (Continued)****8. Special Investment Techniques**

The Fund may employ certain investment techniques in accordance with its fundamental investment policies. These may include the use of when-issued and delayed delivery transactions. Securities purchased or sold on a when-issued or delayed delivery basis may be settled within 45 days after the date of the transaction. Such transactions may expose the Fund to credit and market valuation risk greater than that associated with regular trade settlement procedures. The Fund may also enter into transactions, in accordance with its fundamental investment policies, involving any or all of the following: lending of portfolio securities, short sales of securities, futures contracts, interest rate swaps, options on futures contracts, options on securities and swaptions and certain credit derivative transactions, including, but not limited to, the purchase and sale of credit protection. As in the case of when-issued securities, the use of over-the-counter derivatives, such as interest rate swaps, swaptions, and credit default swaps may expose the Fund to greater credit, operations, liquidity, and valuation risk than is the case with regulated, exchange traded futures and options. These transactions are used for hedging or other appropriate risk-management purposes, or, under certain other circumstances, to increase return. No assurance can be given that such transactions will achieve their desired purposes or will result in an overall reduction of risk to the Fund.

Flaherty & Crumrine Preferred Income Fund Incorporated

## **ADDITIONAL INFORMATION (Unaudited)**

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

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

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

Plan participants are not subject to any charge for reinvesting dividends or capital gains distributions. Each Plan participant will, however, bear a proportionate share of brokerage commissions incurred with respect to PFPC Inc.'s open market purchases in connection with the reinvestment of dividends or capital gains distributions. For the six months ended May 31, 2005, 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.

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

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

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

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

**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 initial Form N-PX with the Securities and Exchange Commission ("SEC") on August 18, 2004. 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 1-800-331-1710, (ii) on the Fund's website at [www.preferredincome.com](http://www.preferredincome.com) and (iii) on the SEC's website at [www.sec.gov](http://www.sec.gov).

**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 February 28, 2005. 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 or 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, Stimes, 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 beginning on page 31.

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

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

Donald F. Crumrine, as the Fund's Chief Executive Officer, has certified to the New York Stock Exchange that, as of May 18, 2005, he was not aware of any violation by the Fund of applicable NYSE corporate governance listing standards. The Fund's reports to the SEC on Forms N-CSR and N-Q contain certifications by the Fund's principal executive officer and principal financial officer that relate to the Fund's disclosure in such reports and that are required by rule 30a-2(a) under the 1940 Act.

**Meeting of Shareholders**

On April 21, 2005, the Fund held its Annual Meeting of Shareholders (the "Meeting") for the following purposes: election of directors of the Fund ("Proposal 1"), approval of an amendment to the Fund's Articles Supplementary Creating and Fixing the Rights of Money Market Cumulative Preferred™ Stock ("Articles Supplementary") relating to the term of office of certain Directors ("Proposal 2") and approval of an amendment to the Fund's Articles Supplementary adding a Force Majeure Provision to regulate the auction process following an extraordinary event ("Proposal 3"). With respect to Proposal 3, the meeting was adjourned and reconvened on May 2, 2005 and subsequently on May 27, 2005. All proposals were approved by shareholders and the results of the proposals are as follows:

**Proposal 1: Election of Directors.**

<u>Name</u>	<u>For</u>	<u>Withheld</u>
<b>Common Stock</b>		
David Gale .....	7,378,499	90,523
	<u>For</u>	<u>Withheld</u>
<b>Preferred Stock</b>		
Karen H. Hogan .....	605	135

Donald F. Crumrine, Morgan Gust, and Robert F. Wulf continue to serve in their capacities as Directors of the Fund.

**Proposal 2: Amendment to the Articles Supplementary relating to the term of office of certain Directors.**

	<u>For</u>	<u>Against</u>	<u>Withheld</u>
<b>Common Stock</b> .....	7,237,411	107,420	124,191
<b>Preferred Stock</b> .....	740	—	—

**Proposal 3: Amendment to the Articles Supplementary adding a Force Majeure Provision to regulate the auction process following an extraordinary event.**

	<u>For</u>	<u>Against</u>	<u>Withheld</u>
<b>Common Stock</b> .....	7,242,591	95,710	130,720
<b>Preferred Stock</b> .....	655	85	—

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

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

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

<u>Name, Address, and Age</u>	<u>Position(s) Held with Fund</u>	<u>Term of Office and Length of Time Served*</u>	<u>Principal Occupation(s) During Past Five Years</u>	<u>Number of Funds in Fund Complex Overseen by Director</u>	<u>Other Directorships Held by Director</u>
<b>NON-INTERESTED DIRECTORS:</b>					
<b>David Gale</b> Delta Dividend Group, Inc. 220 Montgomery Street Suite 426 San Francisco, CA 94104 Age: 56	Director	Class I Director since 1997	President & CEO of Delta Dividend Group, Inc. (investments).	4	Director, Metromedia International Group, Inc. (telecommunications). Director, Flaherty & Crumrine Preferred Income Opportunity Fund, Flaherty & Crumrine/ Claymore Preferred Securities Income Fund and Flaherty & Crumrine/ Claymore Total Return Fund.
<b>Morgan Gust</b> Giant Industries, Inc. 23733 N. Scottsdale Road Scottsdale, AZ 85255 Age: 58	Director	Class III Director since 1991	Since March 2002, President of Giant Industries, Inc. (petroleum refining and marketing) and for more than five years prior thereto, Executive Vice President, and various other Vice President positions at Giant Industries, Inc.	4	Director, Flaherty & Crumrine Preferred Income Opportunity Fund, Flaherty & Crumrine/ Claymore Preferred Securities Income Fund and Flaherty & Crumrine/ Claymore Total Return Fund.

\* 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 2008 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 2006 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

**Class III Directors** – three year term expires at the Fund's 2007 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

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

<u>Name, Address, and Age</u>	<u>Position(s) Held with Fund</u>	<u>Term of Office and Length of Time Served*</u>	<u>Principal Occupation(s) During Past Five Years</u>	<u>Number of Funds in Fund Complex Overseen by Director</u>	<u>Other Directorships Held by Director</u>
<b>NON-INTERESTED DIRECTORS:</b>					
<b>Karen H. Hogan†</b> 905 North Bedford Drive Beverly Hills, CA 90210 Age: 44	Director	Class I Director since April 2005	Retired; Community Volunteer; from September 1985 to January 1997, Senior Vice President of Preferred Stock Origination at Lehman Brothers and previously, Vice President of New Product Development.	2	Director, Flaherty & Crumrine Preferred Income Opportunity Fund.
<b>Robert F. Wulf</b> 3560 Deerfield Drive South Salem, OR 97302 Age: 68	Director	Class II Director since 1991	Financial Consultant; Trustee, University of Oregon Foundation; Trustee, San Francisco Theological Seminary.	4	Director, Flaherty & Crumrine Preferred Income Opportunity Fund, Flaherty & Crumrine/Claymore Preferred Securities Income Fund and Flaherty & Crumrine/Claymore Total Return Fund.

\* 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 2008 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 2006 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

**Class III Directors** – three year term expires at the Fund's 2007 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

† As a Director, represents holders of shares of the Fund's Money Market Cumulative Preferred™ Stock.



Flaherty &amp; Crumrine Preferred Income Fund Incorporated

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

<u>Name, Address, and Age</u>	<u>Position(s) Held with Fund</u>	<u>Term of Office and Length of Time Served*</u>	<u>Principal Occupation(s) During Past Five Years</u>	<u>Number of Funds in Fund Complex Overseen by Director</u>	<u>Other Directorships Held by Director</u>
<b>INTERESTED DIRECTOR:</b>					
<b>Donald F. Crumrine</b> †, †† 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 57	Director, Chairman of the Board and Chief Executive Officer	Class II Director since 1991	Chairman of the Board and Director of Flaherty & Crumrine Incorporated.	4	Director, Flaherty & Crumrine Preferred Income Opportunity Fund, Flaherty & Crumrine/ Claymore Preferred Securities Income Fund and Flaherty & Crumrine/Claymore Total Return Fund.

\* 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 2008 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 2006 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.  
**Class III Directors** – three year term expires at the Fund's 2007 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

† As a Director, represents holders of shares of the Fund's Money Market Cumulative Preferred™ Stock.

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

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

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

<b><u>Name, Address, and Age</u></b>	<b><u>Position(s) Held with Fund</u></b>	<b><u>Term of Office and Length of Time Served</u></b>	<b><u>Principal Occupation(s) During Past Five Years</u></b>
<b>OFFICERS:</b>			
<b>Robert M. Ettinger</b> 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 46	President	Since 2002	President and Director of Flaherty & Crumrine Incorporated.
<b>R. Eric Chadwick</b> 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 30	Chief Financial Officer, Vice President, Treasurer and Secretary	Since October 2002	Vice President of Flaherty & Crumrine Incorporated since August 2001, and portfolio manager of Flaherty & Crumrine Incorporated.
<b>Peter C. Stimes</b> 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 49	Chief Compliance Officer and Vice President	Since 1991	Vice President of Flaherty & Crumrine Incorporated.
<b>Bradford S. Stone</b> 392 Springfield Avenue Mezzanine Suite Summit, NJ 07901 Age: 45	Vice President and Assistant Treasurer	Since July 2003	Since May 2003, Vice President of Flaherty & Crumrine Incorporated; from June 2001 to April 2003, Director of U.S. Market Strategy at Barclays Capital; from February 1987 to June 2001 Vice President of Goldman, Sachs & Company as Director of U.S. Interest Rate Strategy and, previously, Vice President of Interest Rate Product Sales.
<b>Christopher D. Ryan</b> 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 37	Vice President	Since April 2005	Since February 2004, Vice President of Flaherty & Crumrine Incorporated; October 2002 to February 2004, Product Analyst of Flaherty & Crumrine Incorporated.
<b>Laurie C. Lodolo</b> 301 E. Colorado Boulevard Suite 720 Pasadena, CA 91101 Age: 41	Assistant Compliance Officer, Assistant Treasurer and Assistant Secretary	Since July 2004	Since August 2004, Assistant Compliance Officer of Flaherty & Crumrine Incorporated; since February 2004, Secretary of Flaherty & Crumrine Incorporated; Account Administrator of Flaherty & Crumrine Incorporated.

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**ADDITIONAL INFORMATION (Unaudited) (Continued)****BOARD CONSIDERATION AND APPROVAL OF CONTINUANCE OF INVESTMENT  
ADVISORY AGREEMENT**

During the six month period ended May 31, 2005, the Board of Directors of the Fund approved the continuation of the investment advisory agreement with the Adviser (the "Agreement"). The following paragraphs summarize the material information and factors considered by the Board, including the Independent Directors, as well as their conclusions relative to such factors.

**Nature, Extent and Quality of Services**

The Board members reviewed in detail the nature and extent of the services provided by the Adviser and the quality of those services over the past year and since inception. The Board members noted that these services included managing the Fund's investment program, as well as providing significant administrative services beyond what the Agreement required. The Board members noted that the Adviser also provided, generally at its expense: office facilities for use by the Fund; personnel responsible for supervising the performance of administrative, accounting and related services; and investment compliance monitoring. The Board also considered the Adviser's sound financial condition and the Adviser's commitment to its business as evidenced by its hiring of additional personnel as the business has grown. The Board members evaluated the Adviser's provision of services based on their direct experience over many years as Fund Directors and focused on (i) the Adviser's knowledge of the preferred stock market generally and the sophisticated hedging strategies the Fund employs and (ii) its culture of compliance. The Board members reviewed the personnel responsible for providing services to the Fund and observed, based on their experience and interaction with the Adviser, that (1) the Adviser's personnel exhibited a high level of diligence and attention to detail in carrying out their responsibilities under the Agreement, (2) the Adviser was responsive to requests of the Board and its personnel were available between Board meetings to answer Board member questions, and (3) the Adviser had kept the Board apprised of developments relating to the Fund. The Board members concluded that the nature and extent of the services provided were reasonable and appropriate in relation to the Fund's investment goals and strategies, the corporate and regulatory environment in which the Fund operates, the level of services provided by the Adviser, and the quality of service, which continued to be high.

**Investment Performance**

The Board members considered the Fund's performance from inception and more recently to determine whether the Fund had met its investment objective. The Board determined that the Fund had done so. In so doing, the Board members reviewed performance compared to relevant indices and funds thought generally to be comparable to the Fund, considered the costs and benefits of the Fund's hedging strategy and examined the differences between the Fund and certain funds in the comparison group, including the significant positions a number of preferred stock funds had in common equities. The Board members noted the Fund's long-term performance and specifically recognized that recent relative underperformance was attributable largely to the Fund's stated hedging strategies, which over time are expected to benefit the Fund, and the Fund's adherence to its respective investment mandate.

Flaherty & Crumrine Preferred Income Fund Incorporated

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

### **Profitability**

The Board members considered the Adviser's methodology for determining its profitability with respect to the Fund and the Adviser's profit margin on an after-tax basis attributable to managing the Fund. The Board concluded that the profitability to the Adviser was not excessive based on the considerable services it provides to the Fund, the Fund's relative performance over time, its success in meeting the Fund's investment objective and the Fund's relatively low expense ratio. The Board members also considered the Adviser's provision, at a lower cost, of services to separate account clients and determined that the difference was justified in light of the additional services and costs associated with managing registered investment companies, such as the Fund. The Board accepted the Adviser's statement that it did not realize material indirect benefits from its relationship with the Fund and did not obtain soft dollar credits from securities trading.

### **Economies of Scale**

The Board members noted that the Fund, as a closed-end investment company, was not expected to increase materially in size; thus, the Adviser would not benefit from economies of scale. The Board members considered whether economies of scale could be realized because the Adviser advises other similar funds, and, based on their experience, accepted the Adviser's explanation that significant economies of scale would not be realized because of the nature of the preferred securities market in which the Fund invests. Nonetheless, the Board members noted that the Fund's advisory fee schedule declines as assets increase beyond a certain level (commonly known as a "breakpoint") and that breakpoints provide for a sharing with shareholders of benefits derived as a result of economies of scale arising from increased assets. Accordingly, the Board determined that the existing advisory fee levels reflect possible economies of scale.

Based on their discussions and considerations as described above, the Board made the following conclusions and determinations as to the Fund:

- The Board concluded that the nature, extent and quality of the services provided by the Adviser are adequate and appropriate.
- The Board was satisfied with the Fund's overall performance.
- The Board concluded that the fee paid to the Adviser was reasonable in light of comparative performance and expense and advisory fee information, costs of the services provided and profits to be realized and benefits derived or to be derived by the Adviser from the relationship with the Fund.
- The Board determined that there were not at this time significant economies of scale to be realized by the Adviser in managing the Fund's assets and that the fee was structured to provide for a sharing of the benefits of economies of scale.
- The Board members considered these factors, conclusions and determinations in their totality and, without any one being dispositive, the Board determined that approval of the Agreement was in the best interests of the Fund and its shareholders.

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**ADDITIONAL INFORMATION (Unaudited) (Continued)****AMENDMENTS TO CHARTER AND BYLAWS**

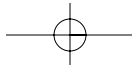
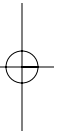
In addition to the changes to the Fund's Charter that were approved by Shareholders at the April 21, 2005 Annual Meeting of Shareholders, the Board of Directors approved Articles Supplementary to the Fund's Charter and Amended and Restated Bylaws ("Bylaws") at its April 21, 2005 meeting. Among the changes reflected in the Fund's Bylaws are a bylaw amendment and related Articles Supplementary reflecting the Board's determination to opt in to certain provisions of the Maryland Unsolicited Takeover Act. Such action provides that (1) the number of directors can be fixed only by the Board and (2) a director elected by the Board to fill a Board vacancy holds office until the end of the term of the class to which the director has been elected (rather than until the next annual meeting).

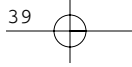
At its April 21, 2005 Board meeting, the Board also approved an amendment to the Bylaws to reserve exclusively to the directors the power to amend the by-laws, which previously could be amended by either the directors or the holders of a majority of the outstanding shares of the Fund. This change enhances the Board's ability to control Fund operations, including the manner in which shareholder meetings are conducted and the procedure for setting the agenda for those meetings, as well as the Board nomination process and the vote required to remove a director. At the same meeting, the Board also approved amendments to the Bylaws to clarify certain aspects of the calling of a Special Meeting of Shareholders. Specifically, such bylaw amendment clarifies that if a shareholder or group of shareholders has requested and paid for a special meeting of Shareholders, another Shareholder cannot add an additional proposal to the proxy statement for that meeting.

The Board determined that the changes to the Bylaws and related Articles Supplementary provide the Fund with certain additional protections in the case of a hostile takeover bid to gain control of the Fund and change the objective to the detriment of long-term shareholders. However, the Board is aware of no such hostile takeover bid at the present time.

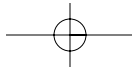
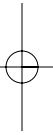
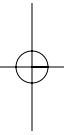


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#### Directors

Donald F. Crumrine, CFA  
David Gale  
Morgan Gust  
Karen H. Hogan  
Robert F. Wulf, CFA

#### Officers

Donald F. Crumrine, CFA  
Chairman of the Board  
and Chief Executive Officer  
Robert M. Ettinger, CFA  
President  
R. Eric Chadwick, CFA  
Chief Financial Officer,  
Vice President, Treasurer  
and Secretary  
Peter C. Stimes, CFA  
Chief Compliance  
Officer and Vice President  
Bradford S. Stone  
Vice President and  
Assistant Treasurer  
Christopher D. Ryan, CFA  
Vice President  
Laurie Lodolo  
Assistant Compliance Officer,  
Assistant Treasurer and  
Assistant Secretary

#### Investment Adviser

Flaherty & Crumrine Incorporated  
e-mail: 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**  
**PREFERRED INCOME FUND**

## Semi-Annual Report

May 31, 2005

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