FLAHERTY & CRUMRINE PREFERRED INCOME OPPORTUNITY FUND

To the Shareholders of the Flaherty & Crumrine Preferred Income Opportunity Fund ("PFO"):

The Fund completed a successful fiscal year on November 30, 2006, returning **+5.3%**[1] total return on net asset value ("NAV") during the fourth fiscal quarter and **+10.8%**[1] for the full year. The total return based on the market price of the Fund's common shares for the year was even better, with the combination of income and share price appreciation totaling **+15.2%**, and the Fund's discount from NAV narrowed significantly.

The table below compares the return on the Fund since its inception with a broad group of fixed-income, closed-end funds. Although the investment strategies used by the Fund differ significantly from the strategies used by these other fixed-income funds, we believe that the Fund addresses similar investment goals with better results. As the numbers indicate, the Fund has performed very well, benefiting from strength in the overall market for preferred securities as well as some strategic shifts in the portfolio.

TOTAL RETURN PER YEAR ON NET ASSET VALUE[1]
FOR PERIODS ENDED NOVEMBER 30, 2006

	One Year	Three Years	Five Years	Ten Years	Life of Fund[2]
Flaherty & Crumrine Preferred Income Opportunity Fund	10.8%	7.4%	9.6%	8.7%	10.0%
Lipper Domestic Investment Grade Funds[3]	7.3%	5.7%	6.3%	6.6%	7.0%

(1) Based on monthly data provided by Lipper Inc. in each calendar month during the relevant period. Distributions are assumed to be reinvested at NAV in accordance with Lipper's practice, which differs from the methodology used elsewhere in this report.

(2) Since inception on February 13, 1992.

(3) Includes all funds in Lipper's U.S. Government, U.S. Mortgage and Corporate Debt BBB Rated categories in each month during the period.

The steady stream of new preferred issues continued during the past quarter. In the twelve months ended November 30, 2006, roughly $75 billion of preferred securities were issued – over $23 billion in the last quarter alone. The recently-devised enhanced preferred security structure has been very popular with issuers and investors, and these issues comprised a large portion of the new supply. However, issuers have also brought to market traditional hybrid preferred securities and traditional DRD and QDI eligible issues, with both adjustable and fixed coupons. For us old-timers, it has been interesting to observe that billion dollar deals are commonplace and that investors usually can't get enough to satisfy their interest.

The Fund has benefited from the vibrant new issue market – not only have we been able to pick and choose from a variety of issues and issuers, but the new supply has improved liquidity in older issues as well. You can see the results of this new supply and additional liquidity in the turnover of the Fund's portfolio when compared to recent years.

Although the investor base for preferred securities appears to have grown materially, the current pace of new-issue supply has us wondering if demand can keep up. The trend is healthy, but only time will tell if these new investors are in it for the long haul.

In a number of instances, proceeds from new issues were used to redeem older, more expensive (from the issuer's perspective) issues. This is a trend we have anticipated and discussed often in the past, but it is worth reviewing once again. Just like a homeowner may refinance a mortgage when there are savings to be had, issuers of preferred securities will replace older issues with newer ones when there are benefits in doing so. The benefit may be simply to lower the "payments," or the issuer may find additional benefits from adding some features that weren't available previously.

We work hard to anticipate redemptions. This is important because if the issuer can save money by "refinancing," the investor is probably going to earn less. While this trend may reduce the amount of income available for distribution to Common Stock Shareholders of the Fund, there are ways to mitigate the impact. The best way to avoid redemptions is to own securities that issuers either can't or don't want to redeem. We can also lessen the impact of redemptions by selling the security prior to the date it can be redeemed. This provides us with greater flexibility in replacing the position.

Forecasting redemptions is a critical step in determining the dividend rate the Fund can pay its Common Stock Shareholders. Some redemptions of securities held by the Fund are inevitable, and better understanding the income the Fund will receive guides us in making recommendations to the Board of Directors about dividend policy.

Since dividends are effectively driven by the *net* income of the Fund's portfolio, forecasting the Fund's expenses is also crucial in setting the dividend rate. A primary variable in the Fund's expenses is the cost of its use of leverage, which has been fairly unpredictable over the past several years. The Fund's leverage cost is directly impacted by the short-term interest rates set by the Federal Reserve. As the Federal Reserve raised interest rates (an unprecedented 17 consecutive times between June 2004 and June 2006), the cost of leverage increased by approximately 190%, from $1.0 million for the year ended November 30, 2004 to $2.9 million for the year ended November 30, 2006. During a two-year period in which the income earned on the portfolio increased only moderately, this additional cost had a negative impact on the amount of income available to be distributed to the holders of the Fund's 11.6 million outstanding shares of Common Stock.

Even in today's interest-rate environment, however, the use of leverage continues to be a beneficial strategy to the Fund's Common Stock Shareholders. In other words, the preferred securities in the portfolio continue to have a higher return than the short-term rates the Fund pays for its leverage, and that difference in return is passed on to the Fund's Common Stock Shareholders.

In August 2006, the Federal Reserve finally gave markets a reprieve from its relentless increasing of short-term interest rates, and now the market is unsure if the Federal Reserve will lower, increase or keep rates the same during coming months. These decisions will impact the Fund's available distributable income. If the Federal Reserve maintains its current pause on short-term rates, and long-term rates do not decrease materially, the Fund's leverage should continue to produce similar amounts of additional distributable income to what it does now. Of course, if the Federal Reserve lowers short-term interest rates, the Fund should see a greater benefit from its use of leverage and consequently have additional distributable income for its Common Stock Shareholders.

We hope investors will take advantage of the Fund's website at www.preferredincome.com. It contains a wide range of useful and up-to-date information about the Fund, and the "Frequently Asked Questions" section has enhanced discussions about many of the topics discussed in this Annual Report.

Sincerely,

Donald F. Crumrine
Chairman of the Board

Robert M. Ettinger
President

January 23, 2007