

PREFERRED INCOME OPPORTUNITY FUND INCORPORATED

Dear Shareholder:

The Preferred Income Opportunity Fund has been “hanging in there” in these troubled times. Total return on the net asset value (“NAV”) of the shares was 4.0% for the third fiscal quarter, which brought the return for the last twelve months up to 5.6%.

In the last quarter, the securities markets were all over the map reflecting a struggling economy, jitters over terrorists and Iraq, rumored and actual corporate misdeeds, and the upcoming congressional election. Weak common stock prices produced a “flight to quality” and a strong rally in the Treasury bond market. However, corporate bonds and preferreds did not fully participate in the prosperity of Treasuries. Credit concerns, reinforced by a rash of bankruptcies, particularly pressured lower-rated corporate issues.

The Fund’s hedges were an “artistic success”, even though they lost money in the quarter. A flight to quality that causes Treasuries to outperform preferreds can make hedging a losing game. Fortunately, we anticipated this possibility and limited our exposure to hedge losses. In technical terms, the Fund held put options on Treasury bond futures that were further out-of-the-money than usual.

The Fund’s hedges are similar to an insurance policy that is subject to a deductible. Currently, our position is equivalent to having a big deductible, which is great for holding down the cost of hedging. However, it also provides less protection against rising interest rates, which is the basic purpose of the hedge. These are unusual times, and we think this approach is appropriate now.

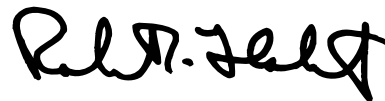
The two main sectors of the preferred market have been “out of sync” so far in fiscal 2002. Earlier this year, hybrid preferreds outperformed traditional preferreds, which offer special tax advantages to corporate investors. In the latest quarter, the roles were reversed with traditional preferreds leading the way. Having one sector zig each time the other zagged actually helped smooth out some of the market’s volatility.

Despite their better performance recently, we still see attractive opportunities among traditional preferreds. During the last quarter, we added slightly to our holdings of traditional issues, reducing hybrid preferreds in the process. At the end of the quarter, hybrids accounted for just under 23% of the Fund’s portfolio, the lowest position in over four years.

Credit risk is widespread today. Otherwise healthy enterprises can be turned into basket cases as lenders and investors boycott companies in need of cash. Distressed sellers of perfectly good assets far outnumber the willing buyers with ready cash. On the positive side, corporate managers are rapidly realizing that it is time to clean up their acts and their balance sheets.

The Fund’s portfolio holds preferreds of two issuers, Consec Inc. and Farmland Industries Inc., that are undergoing financial restructurings. Those two preferreds represented only about 0.2% of the Fund’s portfolio on August 31st.

Sincerely,



Robert T. Flaherty
Chairman of the Board

September 18, 2002

Preferred Income Opportunity Fund Incorporated

SUMMARY OF INVESTMENTS

August 31, 2002 (Unaudited)

	Value (000's)	Percent of Total Net Assets
Adjustable Rate Preferred Securities		
Utilities	\$ 221	0.1%
Banking	19,869	10.1
Financial Services	469	0.2
Total Adjustable Rate	<u>20,559</u>	<u>10.4</u>
Fixed Rate Preferred Securities		
Utilities	71,815	36.2
Banking	28,620	14.4
Financial Services	31,518	15.9
Insurance	18,951	9.6
Oil and Gas	8,919	4.5
Miscellaneous Industries	5,559	2.8
Total Fixed Rate	<u>165,382</u>	<u>83.4</u>
Inverse Floating Rate Preferred Securities	1,544	0.8
Total Preferred Stocks and Securities	187,485	94.6
Debt Securities	437	0.2
Common Stocks	5,390	2.7
Purchased Put Options	882	0.5
Money Market Funds	<u>478</u>	<u>0.2</u>
Total Investments	194,672	98.2
Other Assets and Liabilities (Net)	<u>3,512</u>	<u>1.8</u>
Total Net Assets	<u>\$198,184</u>	<u>100.0%</u>

FINANCIAL DATA

Per Share of Common Stock (Unaudited)

	Dividend Paid	Net Asset Value	NYSE Closing Price	Dividend Reinvestment Price (1)
December 31, 2001	\$0.1360	\$11.49	\$11.85	\$11.49
January 31, 2002	0.0680	11.43	12.05	11.49
February 28, 2002	0.0680	11.33	12.00	11.40
March 31, 2002	0.0680	11.24	11.69	11.24
April 30, 2002	0.0680	11.21	11.95	11.26
May 31, 2002	0.0680	11.10	11.95	11.16
June 30, 2002	0.0730	11.15	12.19	11.78
July 31, 2002	0.0730	11.05	12.48	11.86
August 31, 2002	0.0730	11.33	12.55	11.92

(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.

STATEMENT OF CHANGES IN NET ASSETS AVAILABLE TO COMMON STOCK⁽¹⁾
Nine Months Ended August 31, 2002 (Unaudited)

	<u>Value</u> <u>(000's)</u>
OPERATIONS:	
Net investment income	\$ 9,223
Net realized loss on investments sold	(2,340)
Net unrealized depreciation of investments during the period	(1,179)
Distributions to Money Market Cumulative Preferred™ Stock Shareholders from net investment income, including changes in accumulated undeclared distributions	<u>(907)</u>
Net increase in net assets from operations	4,797
DISTRIBUTIONS:	
Dividends paid from net investment income to Common Stock Shareholders (2)	(7,816)
Distributions paid from net realized capital gains to Common Stock Shareholders	<u>—</u>
Total Distributions	<u>(7,816)</u>
FUND SHARE TRANSACTIONS:	
Increase from Common Stock transactions	<u>1,302</u>
NET DECREASE IN NET ASSETS AVAILABLE TO COMMON STOCK FOR THE PERIOD	(1,717)
NET ASSETS AVAILABLE TO COMMON STOCK:	
Beginning of period	<u>129,792</u>
End of period	<u>\$ 128,075</u>

FINANCIAL HIGHLIGHTS⁽¹⁾
Nine Months Ended August 31, 2002 (Unaudited)
For a Common share outstanding throughout the period.

OPERATING PERFORMANCE:	
Net asset value, beginning of period	\$ 11.60
INVESTMENT OPERATIONS:	
Net investment income	0.82
Net realized loss and unrealized depreciation on investments	(0.31)
DISTRIBUTIONS TO MMP* SHAREHOLDERS:	
From net investment income (including change in accumulated undeclared dividends on MMP*)	(0.08)
From net realized capital gains	<u>0.00</u>
Total from investment operations	<u>0.43</u>
DISTRIBUTIONS TO COMMON SHAREHOLDERS:	
From net investment income	(0.70)
From net realized capital gains	<u>0.00</u>
Total distributions to Common Shareholders	<u>(0.70)</u>
Net asset value, end of period	<u>\$ 11.33</u>
Market value, end of period	<u>\$ 12.55</u>
Common shares outstanding, end of period	<u>11,302,526</u>
RATIOS TO AVERAGE NET ASSETS AVAILABLE TO COMMON STOCK SHAREHOLDERS:	
Net investment income	8.74%**
Operating expenses	1.56%**
SUPPLEMENTAL DATA:††	
Portfolio turnover rate fiscal year to date	21%
Net assets, end of period (in 000's)	\$ 198,184
Ratio of operating expenses to total average net assets including MMP*	1.01%**

(1) These tables summarize the nine months ended August 31, 2002 and should be read in conjunction with the Fund's audited financial statements, including footnotes, in its Annual Report dated November 30, 2001, and in conjunction with the Fund's unaudited financial statements, including footnotes, in its Semi-Annual report dated May 31, 2002.

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

* Money Market Cumulative Preferred™ Stock.

** Annualized.

†† Information presented under heading Supplemental Data includes MMP*.

Directors

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

Officers

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

Investment Adviser

Flaherty & Crumrine Incorporated
e-mail: flaherty@fin-mail.com

**Questions concerning your shares of Preferred
Income Opportunity Fund?**

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

This report is sent to shareholders of Preferred Income Opportunity 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.

The logo for Preferred Income Opportunity Fund features the words "Preferred Income Opportunity" in a large, stylized, italicized serif font. Below this, the word "FUND" is written in a smaller, spaced-out, all-caps serif font, with a horizontal line underneath it. The entire logo is set against a light gray background with a subtle circular shadow effect.

**Preferred
Income
Opportunity**
FUND

Quarterly Report

August 31, 2002

web site: www.preferredincome.com