

HARRIS PREFERRED CAPITAL CORP
Form 10-Q
August 13, 2003

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2003

COMMISSION FILE NUMBER 1-13805

HARRIS PREFERRED CAPITAL CORPORATION
(Exact name of registrant as specified in its charter)

MARYLAND
(State or other jurisdiction
of incorporation or organization)
111 WEST MONROE STREET, CHICAGO, ILLINOIS
(Address of principal executive offices)

36-4183096
(I.R.S. Employer Identification No.)
60603
(Zip Code)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE:
(312) 461-2121

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant is an accelerated filer (as defined in rule 12b-2 of the Act).

Yes No

The number of shares of Common Stock, \$1.00 par value, outstanding on August 12, 2003 was 1,000.

HARRIS PREFERRED CAPITAL CORPORATION

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	(a) Exhibits	
	31.1 Certification of Pamela C. Piarowski pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	
	31.2 Certification of Paul R. Skubic pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	
	32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	
	(b) Reports on Form 8-K	
	None	
Signatures.....		19

HARRIS PREFERRED CAPITAL CORPORATION

BALANCE SHEETS
(UNAUDITED)

	JUNE 30, 2003	DECEMBER 31, 2002	JUNE 2001
	-----	-----	-----
	(IN THOUSANDS, EXCEPT SHARE DATA)		
ASSETS			
Cash on deposit with Harris Trust and Savings Bank.....	\$ 312	\$ 728	\$
Securities purchased from Harris Trust and Savings Bank under agreement to resell.....	17,500	20,000	15,
Notes receivable from Harris Trust and Savings Bank.....	22,933	31,078	41,
Securities available-for-sale:			
Mortgage-backed.....	343,900	365,383	198,
U.S. Treasury.....	114,995	79,976	174,
Securing mortgage collections due from Harris Trust and Savings Bank.....	1,534	2,930	2,
Broker receivable -- due from securities sales.....	--	--	63,
Other assets.....	1,832	1,947	1,
	-----	-----	-----
TOTAL ASSETS.....	\$503,006	\$502,042	\$496,
	=====	=====	=====

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LIABILITIES AND STOCKHOLDERS' EQUITY			
Accrued expenses.....	\$ 82	\$ 96	\$
	-----	-----	-----
Commitments and contingencies.....	--	--	
STOCKHOLDERS' EQUITY			
7 3/8% Noncumulative Exchangeable Preferred Stock, Series A (\$1 par value); liquidation value of \$250,000; 20,000,000 shares authorized, 10,000,000 shares issued and outstanding.....	250,000	250,000	250,
Common stock (\$1 par value); 1,000 shares authorized, issued and outstanding.....	1	1	
Additional paid-in capital.....	240,733	240,733	240,
Earnings in excess of distributions.....	3,938	850	4,
Accumulated other comprehensive income -- unrealized gains on available-for-sale securities.....	8,252	10,362	1,
	-----	-----	-----
TOTAL STOCKHOLDERS' EQUITY.....	502,924	501,946	496,
	-----	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY.....	\$503,006	\$502,042	\$496,
	=====	=====	=====

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

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HARRIS PREFERRED CAPITAL CORPORATION

STATEMENTS OF OPERATIONS
AND COMPREHENSIVE INCOME
(UNAUDITED)

	QUARTER ENDED JUNE 30		SIX MONTHS ENDED
	2003	2002	2003
	----	----	----
	(IN THOUSANDS, EXCEPT PER SHARE DATA)		
INTEREST INCOME:			
Securities purchased from Harris Trust and Savings Bank under agreement to resell....	\$ 296	\$ 638	\$ 543
Notes receivable from Harris Trust and Savings Bank.....	413	740	885
Securities available-for-sale:			
Mortgage-backed.....	4,050	3,235	8,576
U.S. Treasury.....	20	73	68
	-----	-----	-----
Total interest income.....	4,779	4,686	10,072
NON-INTEREST INCOME:			
Gain on sale of securities.....	--	2,695	2,463
	-----	-----	-----
OPERATING EXPENSES:			
Loan servicing fees paid to Harris Trust and Savings Bank.....	19	34	41
Advisory fees paid to Harris Trust and Savings Bank.....	10	19	20
General and administrative.....	70	48	168
	-----	-----	-----
Total operating expenses.....	99	101	229

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Net income.....	4,680	7,280	12,306
Preferred dividends.....	4,609	4,609	9,218
NET INCOME AVAILABLE TO COMMON STOCKHOLDER.....	\$ 71	\$ 2,671	\$ 3,088
Basic and diluted earnings per common share....	\$71.00	\$2,671.00	\$3,088.00
Net income.....	\$4,680	\$ 7,280	\$ 12,306
Other comprehensive income (loss) -- unrealized gains (losses) on available-for-sale securities.....	123	6,208	(2,110)
Comprehensive income.....	\$4,803	\$ 13,488	\$ 10,196

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

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HARRIS PREFERRED CAPITAL CORPORATION
STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(UNAUDITED)

	SIX MONTHS ENDED JUNE 30	
	2003	2002
	(IN THOUSANDS, EXCEPT PER SHARE DATA)	
BALANCE AT JANUARY 1.....	\$501,946	\$489,242
Net income.....	12,306	13,099
Other comprehensive (loss) income.....	(2,110)	3,690
Dividends (preferred stock \$0.4609 per share).....	(9,218)	(9,218)
BALANCE AT JUNE 30.....	\$502,924	\$496,813

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

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HARRIS PREFERRED CAPITAL CORPORATION
STATEMENTS OF CASH FLOWS
(UNAUDITED)

SIX MONTHS ENDED JUNE 30	
2003	2002

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(IN THOUSANDS)

OPERATING ACTIVITIES:		
Net income.....	\$ 12,306	\$ 13,099
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sale of securities.....	(2,463)	(2,695)
Net decrease in other assets.....	115	716
Net decrease in accrued expenses.....	(14)	(56)
	-----	-----
Net cash provided by operating activities.....	9,944	11,064
	-----	-----
INVESTING ACTIVITIES:		
Net decrease in securities purchased from Harris Trust and Savings Bank under agreement to resell.....	2,500	6,000
Repayments of notes receivable from Harris Trust and Savings Bank.....	8,145	14,587
Decrease in securing mortgage collections due from Harris Trust and Savings Bank.....	1,396	3,110
Purchases of securities available-for-sale.....	(340,490)	(371,585)
Proceeds from maturities and sales of securities available-for-sale.....	327,307	345,850
	-----	-----
Net cash used in investing activities.....	(1,142)	(2,038)
	-----	-----
FINANCING ACTIVITIES:		
Cash dividends paid on preferred stock.....	(9,218)	(9,218)
	-----	-----
Net decrease in cash on deposit with Harris Trust and Savings Bank.....	(416)	(192)
Cash on deposit with Harris Trust and Savings Bank at beginning of period.....	728	506
	-----	-----
Cash on deposit with Harris Trust and Savings Bank at end of period.....	\$ 312	\$ 314
	=====	=====
NON-CASH TRANSACTION		
Unsettled security sale.....	\$ --	\$ 63,624
	=====	=====

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

HARRIS PREFERRED CAPITAL CORPORATION

NOTES TO FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

Harris Preferred Capital Corporation (the "Company") is a Maryland corporation whose principal business objective is to acquire, hold, finance and manage qualifying real estate investment trust ("REIT") assets (the "Mortgage Assets"), consisting of a limited recourse note or notes (the "Notes") issued by Harris Trust and Savings Bank (the "Bank") secured by real estate mortgage assets (the "Securing Mortgage Loans") and other obligations secured by real property, as well as certain other qualifying REIT assets. The Company holds its assets through a Maryland real estate investment trust subsidiary, Harris Preferred Capital Trust. Harris Capital Holdings, Inc., a wholly-owned

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subsidiary of the Bank, owns 100% of the Company's common stock.

The accompanying financial statements have been prepared by management from the books and records of the Company, without audit by independent certified public accountants. These statements reflect all adjustments and disclosures which are, in the opinion of management, necessary for a fair statement of the results for the interim periods presented and should be read in conjunction with the notes to financial statements included in the Company's 2002 Form 10-K. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission.

2. COMMITMENTS AND CONTINGENCIES

Legal proceedings in which the Company is a defendant may arise in the normal course of business. There is no pending litigation against the Company.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING INFORMATION

The statements contained in this Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including statements regarding the Company's expectation, intentions, beliefs or strategies regarding the future. Forward-looking statements include the Company's statements regarding tax treatment as a real estate investment trust, liquidity, provision for loan losses, capital resources and investment activities. In addition, in those and other portions of this document, the words "anticipate," "believe," "estimate," "expect," "intend" and other similar expressions, as they relate to the Company or the Company's management, are intended to identify forward-looking statements. Such statements reflect the current views of the Company with respect to future events and are subject to certain risks, uncertainties and assumptions. It is important to note that the Company's actual results could differ materially from those described herein as anticipated, believed, estimated or expected. Among the factors that could cause the results to differ materially are the risks discussed in the "Risk Factors" section included in the Company's Registration Statement on Form S-11 (File No. 333-40257), with respect to the Preferred Shares declared effective by the Securities and Exchange Commission on February 5, 1998. The Company assumes no obligation to update any such forward-looking statement.

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HARRIS PREFERRED CAPITAL CORPORATION

RESULTS OF OPERATIONS

SECOND QUARTER 2003 COMPARED WITH SECOND QUARTER 2002

The Company's net income for the second quarter of 2003 was \$4.7 million. This represented a \$2.6 million or 36% decrease from second quarter 2002 earnings of \$7.3 million. Earnings decreased primarily because of a \$2.7 million gain on sale of securities in second quarter 2002 compared to no gains in the second quarter of 2003.

Second quarter 2003 interest income on the Notes totaled \$413 thousand and yielded 6.4% on \$25.8 million of average principal outstanding for the quarter compared to \$740 thousand and a 6.4% yield on \$46.3 million average principal outstanding for second quarter 2002. The decrease in income was attributable to

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a reduction in the Notes balance because of principal paydowns by customers in the underlying Securing Mortgage Loans. The average outstanding balance of the Securing Mortgage Loans for second quarter 2003 and 2002 was \$32 million and \$57 million, respectively. Interest income on securities available-for-sale for the current quarter was \$4.1 million resulting in a yield of 4.6% on an average balance of \$354 million, compared to \$3.3 million with a yield of 5.4% on an average balance of \$245 million for the same period a year ago. The increase in interest income from available for sale securities is primarily attributable to the increase in the investment portfolio and partially offset by the reduction in yield. As securities mature or are sold, proceeds have been invested in lower yielding securities because market interest rates have generally been declining.

There were no Company borrowings during second quarter 2003 or 2002.

Second quarter 2003 operating expenses totaled \$99 thousand, a decrease of \$2 thousand or 2% from the second quarter of 2002. Loan servicing expenses totaled \$19 thousand, a decrease of \$15 thousand or 44% from a year ago. This decrease is attributable to the reduction in the principal balance of the Notes, thereby reducing servicing fees payable to the Bank. Advisory fees for the second quarter 2003 were \$10 thousand compared to \$19 thousand a year earlier partially due to increased securities processing costs in the second quarter of 2002. General and administrative expenses totaled \$70 thousand, an increase of \$22 thousand or 46% over the same period in 2002, as a result of additional corporate governance costs.

At June 30, 2003 and 2002, there were no Securing Mortgage Loans on nonaccrual status.

The Company does not currently maintain an allowance for loan losses due to the over-collateralization of the Notes represented by the Securing Mortgage Loans.

SIX MONTHS ENDED JUNE 30, 2003 COMPARED WITH JUNE 30, 2002

The Company's net income for the six months ended June 30, 2003 was \$12.3 million. This represented a \$793 thousand or 6% decrease from 2002 earnings of \$13.1 million. Earnings declined primarily because of reduced interest income on earning assets. As assets mature or are sold, proceeds have been invested in lower yielding securities because market interest rates have been declining in the past twelve months.

Interest income on securities purchased under agreement to resell for the six months ended June 30, 2003 was \$543 thousand, a decrease of \$416 thousand from the same period in 2002. Interest income on the Notes for the six months ended June 30, 2003 totaled \$885 thousand and yielded 6.4% on \$28 million of average principal outstanding compared to \$1.6 million of income yielding 6.4% on \$50 million of average principal outstanding for the same period in 2002. The decrease in income was attributable to a reduction in the Note balance because of customer payoffs on the Securing Mortgage Loans. There were no Company borrowings during either period. Interest income on securities available-for-sale for the six months ended June 30, 2003 was \$8.6 million resulting in a yield of 4.8% on an average balance of \$361 million, compared to \$8.1 million of income with a yield of 5.6% on an average balance of \$290 million a year ago. The increase in interest income from available for sale securities is primarily attributable to the increase in the investment portfolio and partially offset by the reduction in yield. As securities mature or are sold, proceeds have been invested in lower yielding securities as a result of market interest rates declining in recent months. Gains from investment

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securities sales for the six months ended June 30, 2003 were \$2.5 million compared to \$2.7 million a year ago. The average outstanding balance of the Securing Mortgage Loans was \$34 million for the six months ended June 30, 2003 and \$61 million for the same period in 2002. There were no Company borrowings during either period.

Operating expenses for the six months ended June 30, 2003 totaled \$229 thousand, an increase of \$2 thousand from a year ago. Loan servicing expenses for the six months ended June 30, 2003 totaled \$41 thousand, a decrease of \$34 thousand or 45% from 2002. This decrease is attributable to the reduction in the principal balance of the Notes because servicing costs vary directly with these balances. Advisory fees for the six months ended June 30, 2003 were \$20 thousand compared to \$27 thousand a year ago; primarily attributable to increased securities processing costs in 2002. General and administrative expenses totaled \$168 thousand, an increase of \$43 thousand or 34% over the same period in 2002, as a result of additional corporate governance costs.

On June 30, 2003, the Company paid a cash dividend of \$0.46094 per share on outstanding preferred shares to the stockholders of record on June 15, 2003, as declared on June 3, 2003. On June 28, 2002, the Company paid a cash dividend of \$0.46094 per share on outstanding preferred shares to the stockholders of record on June 15, 2002, as declared on June 4, 2002. On a year-to-date basis, the Company declared and paid \$9.2 million of dividends to holders of preferred shares for each of the six-month periods ended June 30, 2003 and 2002.

LIQUIDITY RISK MANAGEMENT

The objective of liquidity management is to ensure the availability of sufficient cash flows to meet all of the Company's financial commitments. In managing liquidity, the Company takes into account various legal limitations placed on a REIT.

The Company's principal asset management requirements are to maintain the current earning asset portfolio size through the acquisition of additional Notes or other qualifying assets in order to pay dividends to its stockholders after satisfying obligations to creditors. The acquisition of additional Notes or other qualifying assets is funded with the proceeds obtained as a result of repayment of principal balances of individual Securing Mortgage Loans or maturities or sales of securities. The payment of dividends on the Preferred Shares is made from legally available funds, arising from operating activities of the Company. The Company's cash flows from operating activities principally consist of the collection of interest on the Notes, mortgage-backed securities and other earning assets. The Company does not have and does not anticipate having any material capital expenditures.

In order to remain qualified as a REIT, the Company must distribute annually at least 90% of its adjusted REIT ordinary taxable income, as provided for under the Internal Revenue Code, to its common and preferred stockholders. The Company currently expects to distribute dividends annually equal to 90% or more of its adjusted REIT ordinary taxable income.

The Company anticipates that cash and cash equivalents on hand and the cash flow from the Notes and mortgage-backed securities will provide adequate liquidity for its operating, investing and financing needs.

As presented in the accompanying Statements of Cash Flows, the primary sources of funds in addition to \$9.9 million provided from operations during the six months ended June 30, 2003 were \$8.1 million provided by principal repayments on the Notes and \$327.3 million from the maturities and sales of securities available-for-sale. In the prior period ended June 30, 2002, the primary sources of funds other than \$11.1 million from operations were \$14.6

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million provided by principal repayments on the Notes and \$345.9 million from the maturities and sales of securities available-for-sale. The primary uses of funds for the six months ended June 30, 2003 were \$340.5 million for purchases of securities available-for-sale and \$9.2 million in preferred stock dividends paid. For the prior year's quarter ended June 30, 2002, the primary uses of funds were \$371.6 million for purchases of securities available-for-sale and \$9.2 million in preferred stock dividends paid.

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HARRIS PREFERRED CAPITAL CORPORATION

MARKET RISK MANAGEMENT

The Company's market risk is composed primarily of interest rate risk. There have been no material changes in market risk or the manner in which the Company manages market risk since December 31, 2002.

OTHER MATTERS

As of June 30, 2003, the Company believes that it is in full compliance with the REIT tax rules, and expects to qualify as a REIT under the provisions of the Code. The Company expects to meet all REIT requirements regarding the ownership of its stock and anticipates meeting the annual distribution requirements.

FINANCIAL STATEMENTS OF HARRIS TRUST AND SAVINGS BANK

The following unaudited financial information for the Bank is included because the Company's preferred shares are automatically exchangeable for a new series of preferred stock of the Bank upon the occurrence of certain events.

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HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CONDITION (UNAUDITED)

	JUNE 30 2003	DECEMBER 31 2002
	-----	-----
	(IN THOUSANDS EXCEPT SHA	
ASSETS		
Cash and demand balances due from banks.....	\$ 1,096,975	\$ 1,057,254
Money market assets:		
Interest-bearing deposits at banks.....	355,839	417,206
Federal funds sold and securities purchased under agreement to resell.....	679,238	237,950
Trading account assets.....	52,948	42,423
Securities available-for-sale (including \$5.20 billion, \$4.39 billion, and \$2.67 billion of securities pledged as collateral for repurchase agreements at June 30, 2003, December 31, 2002, and June 30, 2002 respectively).....	6,816,419	5,781,360
Loans.....	9,802,195	9,607,887
Allowance for possible loan losses.....	(215,833)	(206,999)
	-----	-----
Net loans.....	9,586,362	9,400,888

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INTEREST INCOME			
Loans, including fees.....	\$121,747	\$129,210	\$239,239
Money market assets:			
Deposits at banks.....	763	375	1,756
Federal funds sold and securities purchased under agreement to resell.....	1,000	2,989	1,695
Trading account.....	404	402	857
Securities available-for-sale:			
U.S. Treasury and Federal agency.....	42,966	47,289	85,475
State and municipal.....	7	5	12
Other.....	348	553	1,469
	-----	-----	-----
Total interest income.....	167,235	180,823	330,503
	-----	-----	-----
INTEREST EXPENSE			
Deposits.....	28,527	43,031	58,846
Short-term borrowings.....	15,334	14,112	29,554
Senior notes.....	1,703	3,944	2,598
Minority interest-dividends on preferred stock of subsidiary.....	4,610	4,609	9,219
Long-term notes.....	2,610	2,840	5,287
	-----	-----	-----
Total interest expense.....	52,784	68,536	105,504
	-----	-----	-----
NET INTEREST INCOME.....	114,451	112,287	224,999
Provision for loan losses.....	30,282	21,761	47,900
	-----	-----	-----
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES.....	84,169	90,526	177,099
	-----	-----	-----
NONINTEREST INCOME			
Trust and investment management fees.....	20,604	22,773	40,342
Money market and bond trading.....	3,635	2,443	6,760
Foreign exchange.....	1,250	536	2,226
Service fees and charges.....	29,182	30,908	56,906
Securities gains.....	5,856	23,337	8,319
Bank-owned insurance investments.....	10,773	12,468	21,569
Foreign fees.....	6,220	5,828	12,438
Other.....	48,554	34,330	98,822
	-----	-----	-----
Total noninterest income.....	126,074	132,623	247,382
	-----	-----	-----
NONINTEREST EXPENSES			
Salaries and other compensation.....	74,294	74,387	153,062
Pension, profit sharing and other employee benefits.....	18,939	15,438	37,062
Net occupancy.....	10,760	10,240	20,568
Equipment.....	14,123	11,867	27,192
Marketing.....	7,518	7,344	14,733
Communication and delivery.....	5,427	5,606	11,025
Expert services.....	7,181	6,978	13,395
Contract programming.....	6,423	6,507	12,766
Other.....	19,900	12,184	38,813
	-----	-----	-----
Total noninterest expenses.....	164,565	150,551	328,616
	-----	-----	-----
Goodwill and other valuation intangibles.....	4,365	3,961	8,515
	-----	-----	-----
Total noninterest expenses.....	168,930	154,512	337,131
	-----	-----	-----
Income before income taxes.....	41,313	68,637	87,350
Applicable income taxes.....	10,795	20,967	23,410
	-----	-----	-----
NET INCOME.....	\$ 30,518	\$ 47,670	\$ 63,940
	=====	=====	=====

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EARNINGS PER COMMON SHARE (based on 10,000,000 average
shares outstanding)

Net Income.....	\$ 3.05	\$ 4.77	\$ 6.39
	=====	=====	=====

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

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HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

	QUARTER ENDED	JUNE 30	SIX MONTHS EN	JUNE 30
	2003	2002	2003	2002
	----	----	----	----
	(IN THOUSANDS)			
NET INCOME.....	\$30,518	\$ 47,670	\$63,940	\$ 9
OTHER COMPREHENSIVE INCOME:				
Unrealized gains on available-for-sale securities:				
Unrealized holding gains arising during the period, net of tax expense for the quarter of \$13,598 in 2003 and \$28,978 in 2002 and net of tax expense for the year-to-date period of \$8,145 in 2003 and \$20,218 in 2002.....	20,806	44,428	12,590	3
Less reclassification adjustment for realized gains included in income statement, net of tax expense for the quarter of \$2,278 in 2003 and \$9,078 in 2002 and net of tax expense for the year-to-date period of \$3,236 in 2003 and \$15,058 in 2002.....	(3,578)	(14,259)	(5,083)	(2)
Other comprehensive income.....	17,228	30,169	7,507	-----
COMPREHENSIVE INCOME.....	\$47,746	\$ 77,839	\$71,447	\$ 9
	=====	=====	=====	=====

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

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HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDER'S EQUITY (UNAUDITED)

2003	2002
----	----

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(IN THOUSANDS)

BALANCE AT JANUARY 1.....	\$1,577,654	\$1,560,677
Net income.....	63,940	91,169
Contributions to capital.....	4,635	3,178
Dividends -- preferred stock.....	(233)	(295)
Dividends -- common stock.....	(35,000)	(120,000)
Other comprehensive income.....	7,507	7,822
	-----	-----
BALANCE AT JUNE 30.....	\$1,618,503	\$1,542,551
	=====	=====

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

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HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

SIX MONTHS ENDED JUNE 30

2003 2002

(IN THOUSANDS)

OPERATING ACTIVITIES:		
Net income.....	\$ 63,940	\$ 91,169
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses.....	47,899	50,318
Depreciation and amortization, including intangibles.....	32,727	28,794
Deferred tax expense.....	1,128	4,271
Gain on sales of securities.....	(8,319)	(38,711)
Increase in bank-owned insurance.....	(21,756)	(23,525)
Trading account net (purchases) sales.....	(2,883)	55,351
Net (increase) decrease in interest receivable.....	(992)	18,253
Net increase (decrease) in interest payable.....	3,642	(5,549)
Net (increase) decrease in loans held for sale.....	(90,507)	60,343
Other, net.....	29,357	(41,128)
	-----	-----
Net cash provided by operating activities.....	54,236	199,586
	-----	-----
INVESTING ACTIVITIES:		
Net decrease (increase) in interest-bearing deposits at banks.....	61,367	(209,860)
Net (increase) decrease in Federal funds sold and securities purchased under agreement to resell.....	(441,288)	55,100
Proceeds from sales of securities available-for-sale.....	214,760	2,071,179
Proceeds from maturities of securities available-for-sale.....	2,409,116	4,421,885
Purchases of securities available-for-sale.....	(3,489,126)	(5,521,560)
Net (increase) decrease in loans.....	(244,193)	415,442
Purchases of premises and equipment.....	(26,896)	(21,081)
Other, net.....	1,065	--
	-----	-----

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Net cash (used) provided by investing activities.....	(1,515,195)	1,211,105
	-----	-----
FINANCING ACTIVITIES:		
Net increase (decrease) in deposits.....	690,156	(120,770)
Net increase (decrease) in Federal funds purchased and securities sold under agreement to repurchase.....	444,656	(1,098,271)
Net increase (decrease) in short-term borrowings.....	868	(147,501)
Proceeds from issuance of senior notes.....	1,625,000	400,000
Repayment of senior notes.....	(1,225,000)	(610,000)
Cash dividends paid on common stock.....	(35,000)	(120,000)
	-----	-----
Net cash provided (used) by financing activities.....	1,500,680	(1,696,542)
	-----	-----
NET INCREASE (DECREASE) IN CASH AND DEMAND BALANCES DUE FROM BANKS.....	39,721	(285,851)
CASH AND DEMAND BALANCES DUE FROM BANKS AT JANUARY 1...	1,057,254	1,203,945
	-----	-----
CASH AND DEMAND BALANCES DUE FROM BANKS AT JUNE 30.....	\$ 1,096,975	\$ 918,094
	=====	=====

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

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HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

NOTES TO THE FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

Harris Trust and Savings Bank (the "Bank") is a wholly-owned subsidiary of Harris Bankcorp, Inc. ("Bankcorp"), a wholly-owned subsidiary of Bankmont Financial Corp. (a wholly-owned subsidiary of Bank of Montreal). The consolidated financial statements of the Bank include the accounts of the Bank and its wholly-owned subsidiaries. Significant intercompany accounts and transactions have been eliminated. Certain reclassifications were made to conform prior year's financial statements to the current year's presentation.

The consolidated financial statements have been prepared by management from the books and records of the Bank, without audit by independent certified public accountants. However, these statements reflect all adjustments and disclosures which are, in the opinion of management, necessary for a fair presentation of the results for the interim periods presented.

Because the results of operations are so closely related to and responsive to changes in economic conditions, the results for any interim period are not necessarily indicative of the results that can be expected for the entire year.

2. LEGAL PROCEEDINGS

The Bank and certain of its subsidiaries are defendants in various legal proceedings arising in the normal course of business. In the opinion of management, based on the advice of legal counsel, the ultimate resolution of these matters will not have a material adverse effect on the Bank's consolidated financial position.

3. CASH FLOWS

For purposes of the Bank's Consolidated Statements of Cash Flows, cash and

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cash equivalents is defined to include cash and demand balances due from banks. Cash interest payments for the six months ended June 30 totaled \$101.9 million and \$148.1 million in 2003 and 2002, respectively. Cash income tax payments over the same periods totaled \$0.6 million and \$24.4 million, respectively.

4. GOODWILL AND OTHER INTANGIBLE ASSETS

The Bank adopted Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets," on January 1, 2002. Under this standard, goodwill and other intangible assets that have indefinite useful lives are not subject to amortization while intangible assets with finite lives are amortized. Goodwill is periodically assessed for impairment, at least annually. Upon adoption of SFAS No. 142, the Bank had no goodwill.

The Bank adopted SFAS No. 147, "Acquisitions of Certain Financial Institutions--an amendment of FASB Statements No. 72 and 144 and FASB Interpretation No. 9," on October 1, 2002. Under this standard, most acquisitions of financial institutions are removed from the scope of SFAS No. 72 and Interpretation No. 9 and are accounted for in accordance with SFAS No. 141, "Business Combinations," and SFAS No. 142. As such, unidentifiable intangible assets recognized and amortized in accordance with SFAS No. 72, "Accounting for Certain Acquisitions of Banking or Thrift Institutions," represent goodwill that will be accounted for under SFAS No. 142. At adoption date, the Bank had an unidentifiable intangible asset that, in accordance with SFAS No. 72, was excluded from the scope of SFAS No. 142 and continued to be amortized through third quarter 2002. Upon adoption of the Statement, the unidentifiable intangible asset was reclassified to goodwill and no longer amortized starting in fourth quarter 2002. Under the transitional requirements of the Statement, the first three quarters of 2002 were restated to reflect the reversal of previously amortized goodwill in those quarters. The earnings impact for each of these three quarters was \$2.35 million pretax (\$1.4 million after tax).

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HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

NOTES TO THE FINANCIAL STATEMENTS -- (CONTINUED)

The Bank's goodwill was subject to the annual impairment test in the fourth quarter of 2002. The fair value of the reporting unit was estimated using a valuation technique based on multiples of book value. The test did not identify potential impairment and no impairment loss was recognized in 2002.

The carrying value of the Bank's goodwill as of June 30, 2003 was \$89.3 million.

As of June 30, 2003, the gross carrying amount and accumulated amortization of the Bank's amortizable intangible assets were \$208.3 million and \$116.2 million, respectively.

Total amortization expense for the Bank's intangible assets was \$4.4 million for the quarter ended June 30, 2003.

Estimated intangible asset amortization expense for the years ending December 31, 2004, 2005, 2006, 2007 and 2008 is \$17.2 million, \$17.4 million, \$17.7 million, \$17.9 million and \$18.1 million, respectively.

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HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

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FINANCIAL REVIEW

SECOND QUARTER 2003 COMPARED WITH SECOND QUARTER 2002

SUMMARY

The Bank had second quarter 2003 net income of \$30.5 million, a decrease of \$17.2 million or 36 percent from second quarter 2002.

Cash ROE was 9.36 in the current quarter and 14.87 in the second quarter 2002. Excluding the impact of unrealized gains and losses in the securities portfolio recorded directly to equity, cash ROE was 9.87 percent in the current quarter, compared to 15.02 percent a year ago.

Second quarter net interest income on a fully taxable equivalent basis was \$117.4 million, up \$2.8 million or 2 percent from \$114.6 million in 2002's second quarter. Average earning assets increased 11 percent to \$16.86 billion from \$15.18 billion in 2002, primarily due to an increase of \$1.64 billion in average securities available for sale. Net interest margin decreased to 2.79 percent in the current quarter from 3.03 percent in the year-ago quarter, reflecting the impact of declining spreads, particularly in the securities portfolio.

The second quarter provision for loan losses of \$30.3 million was up \$8.5 million from \$21.8 million in the second quarter of 2002. Net charge-offs decreased slightly to \$22.7 million from \$22.8 million in the prior year.

Second quarter noninterest income of \$93.7 million decreased \$14.9 million from the same quarter last year. The decrease was primarily due to a \$17.5 million decrease in net gains from sales of investment securities.

Second quarter 2003 noninterest expenses of \$136.6 million increased \$6.0 million or 5 percent from the year ago quarter.

Nonperforming assets at June 30, 2003 were \$202 million or 2.06 percent of total loans, up from \$175 million or 1.79 percent at March 31, 2003, and \$181 million or 1.91 percent a year ago. At June 30, 2003, the allowance for possible loan losses was \$216 million, equal to 2.20 percent of loans outstanding, compared to \$219 million or 2.31 percent at the end of second quarter 2002. As a result, the ratio of the allowance for possible loan losses to nonperforming assets decreased from 121 percent at June 30, 2002 to 107 percent at June 30, 2003.

At June 30, 2003, Tier 1 capital of the Bank amounted to \$1.61 billion, down from \$1.58 billion one year earlier. The regulatory leverage capital ratio was 8.35 percent for the second quarter of 2003 compared to 8.99 percent in the same quarter of 2002. The Bank's capital ratio exceeds the prescribed regulatory minimum for banks. The Bank's June 30, 2003 Tier 1 and total risk-based capital ratios were 9.65 percent and 11.80 percent compared to respective ratios of 10.12 percent and 12.55 percent at June 30, 2002.

SIX MONTHS ENDED JUNE 30, 2003 COMPARED WITH JUNE 30, 2002

SUMMARY

The Bank had net income for the six months ended June 30, 2003 of \$63.9 million, a decrease of \$27.2 million or 30 percent from the same period a year ago.

Excluding the impact of unrealized gains and losses in the securities portfolio, cash ROE was 10.44 percent, down from 14.30 percent last year.

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Net interest income on a fully taxable equivalent basis was \$231.0 million, down \$4.5 million or 2 percent from \$235.5 million in 2002's year-to-date period. Average earning assets increased 5 percent to \$16.36 billion from \$15.57 billion in 2002, primarily attributable to a \$963 million increase in average securities available for sale. Net interest margin decreased to 2.84 percent from 3.04 percent in 2002, reflecting the impact of declining spreads, particularly in the securities portfolio.

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HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

FINANCIAL REVIEW -- (CONTINUED)

The year-to-date 2003 provision for loan losses of \$47.9 million was down \$2.4 million from \$50.3 million in 2002. Net charge-offs were \$39.1 million, a decrease of \$19.9 million from last year, resulting from lower commercial loan write-offs.

Noninterest income of \$180.9 million decreased \$30.0 million from the same period last year. This decrease is attributable to lower net gains from securities sales of \$30.4 million.

Noninterest expenses of \$270.7 million increased \$8.0 million or 3 percent from the year ago period. Income tax expense decreased \$14.0 million, reflecting lower pretax income.

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ITEM 4. CONTROLS AND PROCEDURES

We are responsible for establishing and maintaining a set of disclosure controls and procedures ("DCP") that are designed to ensure that information required to be disclosed by us in the reports filed by us under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. In addition, we are responsible for establishing and maintaining adequate internal control over our financial reporting ("IC") that is designed to provide reasonable assurances that our records are maintained in reasonable detail to accurately and fairly reflect transactions, our transactions are properly authorized, our assets are safeguarded against unauthorized or improper acquisition, use or disposition, and our transactions are properly recorded and reported to permit the preparation of our financial statements in conformity with generally accepted accounting principles.

There were no changes in our IC during our second quarter of 2003 that materially affected or are reasonably likely to materially affect our IC, including any corrective actions with regard to significant deficiencies and material weaknesses.

PART II. OTHER INFORMATION

ITEMS 1, 2, 3, 4 AND 5 ARE BEING OMITTED FROM THIS REPORT BECAUSE SUCH ITEMS ARE NOT APPLICABLE TO THE REPORTING PERIOD.

ITEM 6. (a) EXHIBITS

31.1 CERTIFICATION OF PAMELA C. PIAROWSKI PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

31.2 CERTIFICATION OF PAUL R. SKUBIC PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

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32.1 CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED
PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

(b) REPORTS ON FORM 8-K: NONE

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, Harris Preferred Capital Corporation has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized on the 12th day of August 2003.

/s/ PAUL R. SKUBIC

Paul R. Skubic
Chairman of the Board and President

/s/ PAMELA C. PIAROWSKI

Pamela C. Piarowski
Chief Financial Officer