HARRIS PREFERRED CAPITAL CORP
Form 10-Q
May 13, 2002

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 MARCH 31, 2002

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)	#36-4183096 (I.R.S. Employer Identification No.)
111 WEST MONROE STREET, CHICAGO, ILLINOIS (Address of principal executive offices)	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. 90 days. Yes [X] No [ ]

The number of shares of Common Stock, $1.00 par value, outstanding on May 10, 2001 was 1,000.

HARRIS PREFERRED CAPITAL CORPORATION

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HARRIS PREFERRED CAPITAL CORPORATION

BALANCE SHEETS
(UNAUDITED)

	MARCH 31, 2002	DECEMBER 31, 2001	MARC 20
	(IN THOUSANDS, EXCEPT SHARE DAT		
ASSETS			
Cash on deposit with Harris Trust and Savings Bank	$ 217	$ 506	$ 1
Securities purchased from Harris Trust and Savings Bank under agreement to resell	14,000	21,000	14
Notes receivable from Harris Trust and Savings Bank	48,372	55,962	91
Securities available-for-sale:			
Mortgage-backed	301,978	319,644	342
U.S. Treasury	119,940	84,932	39
Securing mortgage collections due from Harris Trust and Savings Bank	1,695	5,353	4
Other assets	1,827	1,945	2
TOTAL ASSETS	$488,029	$489,342	$495
LIABILITIES AND STOCKHOLDERS' EQUITY			
Accrued expenses	$ 95	$ 100	$
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	1,595	385	5
Accumulated other comprehensive income -- unrealized losses on available-for-sale securities	(4,395)	(1,877)	(1
TOTAL STOCKHOLDERS' EQUITY	487,934	489,242	495

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$488,029	$489,342	$495

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

HARRIS PREFERRED CAPITAL CORPORATION

STATEMENTS OF OPERATIONS
AND COMPREHENSIVE INCOME
(UNAUDITED)

	QUARTER ENDED MARCH 31	
	2002	2001
	(IN THOUSANDS, EXCEPT PER SHARE DATA)	
INTEREST INCOME:		
Securities purchased from Harris Trust and Savings Bank under agreement to resell	$ 320	$ 543
Notes receivable from Harris Trust and Savings Bank	845	1,584
Securities available-for-sale:		
Mortgage-backed	4,683	5,569
U.S. Treasury	97	167
Total interest income	5,945	7,863
NON-INTEREST INCOME:		
Gain on sale of securities	--	2,203
OPERATING EXPENSES:		
Loan servicing fees paid to Harris Trust and Savings Bank	41	75
Advisory fees paid to Harris Trust and Savings Bank	8	12
General and administrative	77	73
Total operating expenses	126	160
Net income	5,819	9,906
Preferred dividends	4,609	4,609
NET INCOME AVAILABLE TO COMMON STOCKHOLDER	$ 1,210	$ 5,297
Basic and diluted earnings per common share	$1,210.00	$5,297.00
Net income	$ 5,819	$ 9,906
Other comprehensive income (loss) -- unrealized gains (losses) on available-for-sale securities	(2,518)	389
Comprehensive income	$ 3,301	$ 10,295

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)

	QUARTER ENDED MARCH 31	
	2002	2001
	(IN THOUSANDS, EXCEPT PER SHARE DATA)	
Balance at January 1	$489,242	$489,824
Net income	5,819	9,906
Other comprehensive income (loss)	(2,518)	389
Dividends (preferred stock $0.4609 per share)	(4,609)	(4,609)
Balance at March 31	$487,934	$495,510

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

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HARRIS PREFERRED CAPITAL CORPORATION

STATEMENTS OF CASH FLOWS
(UNAUDITED)

	QUARTER ENDED MARCH 31	
	2002	2001
	(IN THOUSANDS)	
OPERATING ACTIVITIES:		
Net Income	$ 5,819	$ 9,906
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sale of securities	--	(2,203)
Net decrease (increase) in other assets	118	(251)
Net decrease in accrued expenses	(5)	(31)
Net cash provided by operating activities	5,932	7,421
INVESTING ACTIVITIES:		
Net decrease (increase) in securities purchased from Harris Trust and Savings Bank under agreement to resell	7,000	(11,002)
Repayments of notes receivable from Harris Trust and Savings Bank	7,590	11,349
(Increase) decrease in securing mortgage collections due from Harris Trust and Savings Bank	3,658	(1,256)
Purchases of securities available-for-sale	(119,909)	(138,975)

Proceeds from maturities and sales of securities available-for-sale	100,049	137,316
Net cash used in investing activities	(1,612)	(2,568)
FINANCING ACTIVITIES:		
Cash dividends paid on preferred stock	(4,609)	(4,609)
Net (decrease) increase in cash on deposit with Harris Trust and Savings Bank	(289)	244
Cash on deposit with Harris Trust and Savings Bank at beginning of period	506	819
Cash on deposit with Harris Trust and Savings Bank at end of period	$ 217	$ 1,063

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 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 2001 Form 10-K. Certain items from 2001 have been reclassified to conform with current 2002 presentation. 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.

RESULTS OF OPERATIONS

FIRST QUARTER 2002 COMPARED WITH FIRST QUARTER 2001

The Company's net income for the first quarter of 2002 was $5.8 million. This represented a $4.1 million or 41% decrease from 2001 earnings of $9.9 million. Earnings decreased primarily because of $2.2 million of gains realized from the sale of investment securities in 2001 compared to no gains in 2002 and decreases in income on investments.

First quarter 2002 interest income on the Notes totaled $845 thousand and yielded 6.4% on $52.9 million of average principal outstanding for the quarter compared to $1.6 million and a 6.4% yield on $98.7 million average principal outstanding for first quarter 2001. The decrease in income was attributable to a reduction in the Notes balance because of customer payoffs on the Securing Mortgage Loans. The average outstanding balance of the Securing Mortgage Loans for first quarter 2002 and 2001 was $65 million and $122 million, respectively. Interest income on securities available-for-sale for the current quarter was $4.8 million resulting in a yield of 5.7% on an average balance of $335 million, compared to $5.7 million with a yield of 6.6% on an average balance of $348 million for the same period a year ago. The decrease in interest income is primarily attributable to the reduction in yield. As securities mature or are sold, proceeds have been invested in lower yielding securities because market interest rates have been declining in the past twelve months. Gains from investment securities sales were $2.2 million in first quarter 2001. No security gains or losses were realized in 2002.

There were no Company borrowings during first quarter 2002 or 2001.

First quarter 2002 operating expenses totaled $126 thousand, a decrease of $34 thousand or 21% from the first quarter of 2001. Loan servicing expenses totaled $41 thousand, a decrease of $34 thousand or 45% 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 first quarter 2002 were $8 thousand compared to $12 thousand a year earlier. General and administrative expenses totaled $77 thousand, an increase of $4 thousand over first quarter 2001.

At March 31, 2002 and 2001, 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.

On March 29, 2002, the Company paid a cash dividend of $0.46094 per share on outstanding Preferred Shares to the stockholders of record on March 15, 2002, as declared on March 5, 2002. On March 30, 2001, the Company paid a cash dividend of $0.46094 per share on outstanding Preferred Shares to the stockholders of record on March 15, 2001, as declared on March 2, 2001.

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 liquidity needs are to maintain the current portfolio size through the acquisition of additional Notes or other qualifying assets and 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 of securities held for sale on a reinvested basis. The payment of dividends on the Preferred Shares is made from legally available funds, principally 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 and mortgage-backed securities. 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 $5.9 million provided from operations during the three months ended March 31, 2002 were $7.5 million provided by principal payments on the Notes and $100.0 million from the maturities of securities available-for-sale. In the prior period ended March 31, 2001, the primary sources of funds other than $7.4 million from operations were $11.3 million provided by principal payments on the Notes and $137.3 million from the sales and maturities of securities available-for-sale. The primary uses of funds for the three months ended March 31, 2002 were $119.9 million for purchases of securities available-for-sale and $4.6 million in preferred stock dividends paid. For the prior year's quarter ended March 31, 2001 the primary uses of funds were $139.0 million for purchases of securities available-for-sale and $4.6 million in preferred stock dividends paid.

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, 2001.

ACCOUNTING PRONOUNCEMENTS

The Company adopted Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations." The Statement addresses financial accounting and reporting for business combinations and supersedes APB Opinion No. 16, "Business Combinations," on July 1, 2001. The Statement addresses financial accounting and reporting for business combinations and supersedes APB Opinion No. 16, "Business Combinations." It requires all business combinations within the scope of the Statement to be accounted for using one method, the purchase method. It establishes criteria for the initial recognition of intangible assets acquired in a business combination. The provisions of the Statement apply to all business combinations initiated after June 30, 2001 and to all business combinations accounted for by using the purchase method for which the date of acquisition is July 1, 2001 or later. The implementation of this Statement has not had a material effect on the Company's financial position or results of operations.

In July 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets." The Statement addresses financial accounting and reporting for acquired goodwill and other intangible assets and supersedes APB Opinion No. 17, "Intangible Assets." Under this Statement, goodwill and other intangible assets that have indefinite useful lives will not be subject to amortization while intangible assets with finite lives will be amortized. The Statement is effective for fiscal years beginning after December 15, 2001. However, goodwill and intangible assets acquired after June 30, 2001 will be subject immediately to the nonamortization and amortization provisions of the Statement. The implementation of this Statement has not had a material effect on the Company's financial position or results of operations.

In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." The Statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The Statement requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs should be capitalized as part of the carrying amount of the long-lived asset. The Statement is effective for financial statements issued for fiscal years beginning after June 15, 2002. The Company does not expect the implementation of this Statement to have a material effect on its financial position or results of operations.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." The Statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets and establishes a single accounting model for long-lived assets to be disposed of by sale. It

HARRIS PREFERRED CAPITAL CORPORATION

NOTES TO FINANCIAL STATEMENTS -- (CONTINUED) supersedes SFAS No. 121 and the accounting and reporting provisions of APB Opinion No. 30 for the disposal of a segment of a business. The Statement is effective for financial statements issued for fiscal years beginning after December 15, 2001 and interim periods within those fiscal years. The implementation of this Statement has not had a material effect on the Company's financial position or results of operations.

OTHER MATTERS

As of March 31, 2002, 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.

HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CONDITION
(UNAUDITED)

	MARCH 31 2002	DECEMBER 31 2001	MARCH 31 2001
	(IN THOUSANDS EXCEPT SHARE DATA)		
ASSETS			
Cash and demand balances due from banks..............	$ 747,152	$ 1,203,946	$ 1,081,2
Money market assets:			
Interest-bearing deposits at banks.................	201,989	195,723	174,0
Federal funds sold and securities purchased under agreement to resell............................	969,150	579,750	394,9
Trading account assets..............................	19,461	90,562	39,9
Securities available-for-sale (including $2.61 billion, $3.21 billion and $3.79 billion of securities pledged as collateral for repurchase at March 31, 2002, December 31, 2001 and March 31, 2001, respectively)...............................	5,126,575	5,822,229	6,593,5
Loans...	9,783,769	9,972,473	10,689,4
Allowance for possible loan losses..................	(219,682)	(227,374)	(115,7
Net loans...	9,564,087	9,745,099	10,573,7
Premises and equipment..............................	288,992	287,549	284,3
Customers' liability on acceptances.................	22,500	13,365	36,3
Bank-owned insurance................................	963,288	952,225	916,6
Loans held for sale.................................	145,311	121,588	125,9
Goodwill and other valuation intangibles............	202,252	206,119	217,3
Other assets..	386,580	518,016	515,7
TOTAL ASSETS................................	$18,637,337	$19,736,171	$20,953,5
LIABILITIES			

Deposits in domestic offices -- noninterest bearing...	$ 2,210,963	$ 3,170,649	$ 2,376,0
-- interest-bearing.....	7,834,926	6,311,796	7,090,9
Deposits in foreign offices -- noninterest bearing...	32,719	38,063	36,8
-- interest-bearing.....	948,075	1,670,352	2,375,9
Total deposits................................	11,026,683	11,190,860	11,879,8
Federal funds purchased and securities sold under agreement to repurchase............................	3,792,338	4,423,351	5,191,8
Short-term borrowings................................	513,805	704,699	884,0
Short-term notes -- senior...........................	860,000	860,000	608,5
Acceptances outstanding..............................	22,500	13,365	36,3
Accrued interest, taxes and other expenses...........	142,294	335,931	257,3
Other liabilities....................................	217,796	167,288	74,5
Minority interest -- preferred stock of subsidiary....	255,000	255,000	250,0
Long-term notes -- subordinated......................	225,000	225,000	225,0
TOTAL LIABILITIES.............................	17,055,416	18,175,494	19,407,4
STOCKHOLDER'S EQUITY			
Common stock ($10 par value); authorized 10,000,000 shares; issued and outstanding 10,000,000 shares....	100,000	100,000	100,0
Surplus..	622,293	620,586	616,3
Retained earnings....................................	861,876	819,991	820,7
Accumulated other comprehensive income (loss).........	(2,248)	20,100	8,9
TOTAL STOCKHOLDER'S EQUITY....................	1,581,921	1,560,677	1,546,0
TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY.....	$18,637,337	$19,736,171	$20,953,5

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

HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

	QUARTER ENDED MARCH 31	
	2002	2001
	(IN THOUSANDS EXCEPT SHARE DATA)	
INTEREST INCOME		
Loans, including fees.....................................	$131,020	$217,646
Money market assets:		
Deposits at banks.......................................	181	841
Federal funds sold and securities purchased under agreement to resell..................................	1,817	4,380
Trading account...	509	749
Securities available-for-sale:		
U.S. Treasury and Federal agency.........................	58,321	98,173
State and municipal.....................................	14	66
Other...	549	433

Total interest income	192,411	322,288
INTEREST EXPENSE		
Deposits	42,861	111,573
Short-term borrowings	17,649	81,552
Senior notes	6,077	8,430
Minority interest-dividends on preferred stock of subsidiary	4,609	4,609
Long-term notes	2,852	3,959
Total interest expense	74,048	210,123
NET INTEREST INCOME	118,363	112,165
Provision for loan losses	28,557	14,458
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	89,806	97,707
NONINTEREST INCOME		
Trust and investment management fees	19,591	22,390
Money market and bond trading	1,684	5,661
Foreign exchange	3,148	1,675
Service fees and charges	30,082	22,128
Securities gains	15,374	12,963
Bank-owned insurance	12,814	11,599
Foreign fees	6,025	5,089
Other	41,008	34,707
Total noninterest income	129,726	116,212
NONINTEREST EXPENSES		
Salaries and other compensation	76,765	68,131
Pension, profit sharing and other employee benefits	15,147	13,612
Net occupancy	9,343	8,656
Equipment	13,714	12,561
Marketing	7,338	6,627
Communication and delivery	5,567	4,668
Expert services	6,270	4,962
Contract programming	7,025	6,698
Other	14,595	18,957
	155,764	144,872
Goodwill and other valuation intangibles	6,173	5,773
Total noninterest expenses	161,937	150,645
Income before income taxes	57,595	63,274
Applicable income taxes	15,567	16,207
NET INCOME	$ 42,028	$ 47,067
EARNINGS PER COMMON SHARE (based on 10,000,000 average shares outstanding)		
Net Income	$ 4.20	$ 4.71

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

HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

	QUARTER ENDED MARCH 31	
	2002	2001
	(IN THOUSANDS)	
Net income	$ 42,028	$47,067
Other comprehensive income:		
Cash flow hedges:		
Cumulative effect of accounting change	--	(7,976)
Net unrealized gain on derivative instruments, net of tax expense $1,189 in 2001	--	2,024
Unrealized (losses) gains on available-for-sale securities:		
Unrealized holding (losses) gains arising during the period, net of tax (benefit) expense of ($8,761) in 2002 and $22,016 in 2001	(12,954)	33,502
Less reclassification adjustment for realized gains included in income statement, net of tax expense of $5,980 in 2002 and $5,043 in 2001	(9,394)	(7,920)
Other comprehensive (loss) income	(22,348)	19,630
Comprehensive income	$ 19,680	$66,697

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)

	2002	2001
	(IN THOUSANDS)	
BALANCE AT JANUARY 1	$1,560,677	$1,524,423
Net income	42,028	47,067
Contributions to capital	1,707	2,975
Dividends -- preferred stock	(143)	--
Dividends -- common stock	--	(48,000)
Other comprehensive (loss) income	(22,348)	19,630
BALANCE AT MARCH 31	$1,581,921	$1,546,095

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

HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	QUARTER ENDED MARCH 31	
	2002	2001
	(IN THOUSANDS)	
OPERATING ACTIVITIES:		
Net income	$ 42,028	$ 47,067
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	28,557	14,458
Depreciation and amortization, including intangibles	16,835	16,845
Deferred tax (benefit) expense	(500)	1,668
Gain on sales of securities	(15,374)	(12,963)
Trading account net sales	71,101	25,301
Net decrease in interest receivable	5,107	42,093
Net increase (decrease) in interest payable	6,397	(12,328)
Net (increase) decrease in loans held for sale	(23,723)	116,363
Other, net	40,862	(13,825)
Net cash provided by operating activities	171,290	224,679
INVESTING ACTIVITIES:		
Net increase in interest-bearing deposits at banks	(6,266)	(32,657)
Net (increase) decrease in Federal funds sold and securities purchased under agreement to resell	(389,400)	96,150
Proceeds from sales of securities available-for-sale	339,285	696,111
Proceeds from maturities of securities available-for-sale	1,355,439	2,060,377
Purchases of securities available-for-sale	(1,020,785)	(2,794,344)
Net decrease in loans	152,455	61,572
Purchases of premises and equipment	(12,105)	(11,233)
Net increase in bank-owned insurance	(11,063)	(10,498)
Other, net	(49,560)	(36,302)
Net cash provided by investing activities	358,000	29,176
FINANCING ACTIVITIES:		
Net decrease in deposits	(164,177)	(613,561)
Net (decrease) increase in Federal funds purchased and securities sold under agreement to repurchase	(631,013)	582,953
Net decrease in short-term borrowings	(190,894)	(605,689)
Proceeds from issuance of senior notes	--	838,500
Repayment of senior notes	--	(619,500)
Cash dividends paid on common stock	--	(48,000)
Net cash used by financing activities	(986,084)	(465,297)

NET DECREASE IN CASH AND DEMAND BALANCES DUE FROM

BANKS...	(456,794)	(211,442)
CASH AND DEMAND BALANCES DUE FROM BANKS AT JANUARY 1...	1,203,946	1,292,694
CASH AND DEMAND BALANCES DUE FROM BANKS AT MARCH 31....	$ 747,152	$ 1,081,252

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

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 cash equivalents is defined to include cash and demand balances due from banks. Cash interest payments (net of amounts capitalized) for the three months ended March 31 totaled $67.7 million and $222.5 million in 2002 and 2001, respectively. Cash income tax payments over the same periods totaled $2.8 million and $16.1 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. The Bank has an unidentifiable intangible asset that is accounted for in accordance with SFAS No. 72, "Accounting for Certain Acquisitions of Banking or Thrift Institutions." The asset is excluded from the scope of SFAS No. 142 and continues to be amortized.

Upon adoption of the Statement and as of March 31, 2002, the Bank had no goodwill.

For the quarters ended March 31, 2002 and March 31, 2001, the Bank had no goodwill amortization expense.

As of March 31, 2002, the gross carrying amount and accumulated amortization of the Bank's amortizable intangible assets was $335.4 million and $133.2 million, respectively.

For the quarter ended March 31, 2002, total amortization expense for the Bank's intangible assets was $6.2 million.

Estimated intangible asset amortization expense for the years ending December 31, 2003, 2004, 2005, 2006 and 2007 is $24.8 million, $25.0 million, $25.2 million, $25.3 million and $25.5 million, respectively.

HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

FINANCIAL REVIEW

FIRST QUARTER 2002 COMPARED WITH FIRST QUARTER 2001

SUMMARY

The Bank had first quarter 2002 net income of $42.0 million, a decrease of $5.1 million or 11 percent from first quarter 2001.

Cash ROE was 13.30 percent in the current quarter and 15.67 percent in first quarter 2001. Excluding unrealized gains and losses on the securities portfolio recorded directly to equity, cash ROE was 13.57 percent for the current year's first quarter, compared to 15.67 percent a year ago. Continued strong earnings growth in the core businesses and a more favorable interest rate environment contributed to increased earnings from treasury activities, but this was offset by an increased loan loss provision reflecting the recession in the U.S. economy.

First quarter net interest income on a fully taxable equivalent basis was $120.9 million, up $3.8 million or 3 percent from $117.1 million in 2001's first quarter. Average earning assets decreased 11 percent to $15.97 billion from $17.92 billion in 2001, primarily attributable to a decrease of 7 percent or $729 million in average loans and $1.3 billion in investment securities. Net interest margin increased to 3.06 percent from 2.39 percent in the same quarter last year.

The first quarter 2002 provision for loan losses of $28.6 million was up from $14.5 million in the first quarter of 2001. Net charge-offs were $36.2 million compared to $17.6 million in the prior year's quarter. Most of the increase resulted from higher commercial loan write offs.

First quarter 2002 noninterest income of $129.7 million increased $13.5 million from the same quarter last year. Most of the increase resulted from additional net gains from securities sales of $2.4 million and higher service charges and fees on deposits of $8.0 million, offset by a decline in bond trading profits, syndication fees and trust revenue.

First quarter 2002 noninterest expenses of $155.8 million increased $10.9 million or 8 percent from the year-ago quarter.

Nonperforming assets at March 31, 2002 were $206 million or 2.10 percent of total loans, compared to $205 million or 2.05 percent at December 31, 2001, and $109 million or 1.02 percent a year ago. At March 31, 2002, the allowance for possible loan losses was $220 million, equal to 2.25 percent of loans outstanding, compared to $116 million or 1.08 percent at the end of first quarter 2001. As a result, the ratio of the allowance for possible loan losses to nonperforming assets was 106 percent at March 31, 2001 compared to 107 percent at March 31, 2002.

At March 31, 2002, Tier 1 capital of the Bank amounted to $1.65 billion, up from $1.58 billion one year earlier. The regulatory leverage capital ratio was 8.91 percent for the first quarter of 2002 compared to 7.65 percent in the same quarter of 2001. The Bank's capital ratio exceeds the prescribed regulatory minimum for banks. The Bank's March 31, 2002 Tier 1 and total risk-based capital ratios were 10.40 percent and 12.83 percent compared to respective ratios of 9.31 percent and 11.23 percent at March 31, 2001.

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) 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 10th day of May, 2002.

/s/ PAUL R. SKUBIC

Paul R. Skubic
Chairman of the Board and President

/s/ PAMELA PIAROWSKI

Pamela Piarowski
Chief Financial Officer