HARRIS PREFERRED CAPITAL CORP
Form 10-Q
November 14, 2007

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United States
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 September 30, 2007

Commission file number 1-13805

Harris Preferred Capital Corporation
(Exact name of registrant as specified in its charter)

Maryland	**# 36-4183096**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Indentification No.)
111 West Monroe Street, Chicago, Illinois	**60603**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code:
(312) 461-2121

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
73/8% Noncumulative Exchangeable Preferred Stock, Series A, par value $1.00 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

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 þ No o

Indicate by check mark whether this registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer o Non-accelerated filer þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes o No þ

The number of shares of Common Stock, $1.00 par value, outstanding on November 13, 2007 was 1,000. No common equity is held by nonaffiliates.

HARRIS PREFERRED CAPITAL CORPORATION

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Part I. FINANCIAL INFORMATION

Item 1. Financial Statements

HARRIS PREFERRED CAPITAL CORPORATION

CONSOLIDATED BALANCE SHEETS

	September 30, 2007 (unaudited)	December 31, 2006 (audited) (in thousands)	September 30, 2006 (unaudited)
Assets			
Cash on deposit with Harris N.A	$ 5,201	$ 5,284	$ 1,026
Securities purchased from Harris N.A. under agreement to resell	9,421	9,854	12,083
Notes receivable from Harris N.A.	5,531	6,512	6,722
Securities available-for-sale:			
Mortgage-backed	379,555	404,075	396,917
U.S. Treasury	89,936	59,948	64,926
Other assets	1,597	1,667	1,646
Total assets	$ 491,241	$ 487,340	$ 483,320
Liabilities			
Accrued expenses	$ 75	$ 120	$ 51
Preferred dividends payable	4,609	4,611	
Total liabilities	$ 4,684	$ 4,731	$ 51
Commitments and contingencies			
Stockholders Equity			
73/8% Noncumulative Exchangeable Preferred Stock, Series A ($1 par value); liquidation value of $250,000,000 and 20,000,000 shares authorized, 10,000,000 shares issued and outstanding	$ 250,000	$ 250,000	$ 250,000
Common stock ($1 par value); 1,000 shares authorized, issued and outstanding	1	1	1
Additional paid-in capital	240,733	240,733	240,733
Earnings in excess of (less than) distributions	2,324	(71)	1,673
Accumulated other comprehensive loss net unrealized losses on available-for-sale securities	(6,501)	(8,054)	(9,138)
Total stockholders equity	486,557	482,609	483,269
Total liabilities and stockholders equity	$ 491,241	$ 487,340	$ 483,320

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

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HARRIS PREFERRED CAPITAL CORPORATION

CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVEV INCOME (Unaudited)

	Quarter Ended September 30, 2007	Quarter Ended September 30, 2006	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
	(in thousands, except per share data)			
Interest income:				
Securities purchased from Harris N.A. under agreement to resell	$ 1,002	$ 1,090	$ 2,860	$ 3,360
Notes receivable from Harris N.A.	89	111	278	360
Securities available-for-sale:				
Mortgage-backed	4,549	4,118	13,671	11,809
U.S. Treasury	75	104	223	307
Total interest income	5,715	5,423	17,032	15,836
Operating expenses:				
Loan servicing fees paid to Harris N.A.	5	5	14	17
Advisory fees	36	32	103	93
General and administrative	54	59	181	223
Total operating expenses	95	96	298	333
Net income	5,620	5,327	16,734	15,503
Preferred dividends	4,609	4,609	13,827	13,828
Net income available to common stockholder	$ 1,011	$ 718	$ 2,907	$ 1,675
Basic and diluted earnings per common share	$ 1,011.00	$ 718.00	$ 2,907.00	$ 1,675.00
Net income	$ 5,620	$ 5,327	$ 16,734	$ 15,503
Other comprehensive income net unrealized gains on available-for-sale securities	4,209	7,912	1,553	1,848
Comprehensive income	$ 9,829	$ 13,239	$ 18,287	$ 17,351

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

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HARRIS PREFERRED CAPITAL CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY
(Unaudited)

	Nine Months Ended September 30, 2007 (in thousands, except per share data)	Nine Months Ended September 30, 2006 (in thousands, except per share data)
Balance at January 1	$ 482,609	$ 479,746
Net income	16,734	15,503
Other comprehensive income	1,553	1,848
Dividends (common stock $511.85 per share)	(512)	
Dividends (preferred stock $0.4609 per share)	(13,827)	(13,828)
Balance at September 30	$ 486,557	$ 483,269

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

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HARRIS PREFERRED CAPITAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
	(in thousands)	
Operating Activities:		
Net Income	$ 16,734	$ 15,503
Adjustments to reconcile net income to net cash provided by operating activities:		
Decrease (increase) in other assets	70	(185)
Net decrease in accrued expenses and other liabilities	(47)	(79)
Net cash provided by operating activities	16,757	15,239
Investing Activities:		
Decrease in securities purchased from Harris N.A. under agreement to resell	433	8,417
Repayments of notes receivable from Harris N.A.	981	1,962
Purchases of securities available-for-sale	(258,795)	(333,447)
Proceeds from maturities of securities available-for-sale	254,880	321,983
Net cash used in investing activities	(2,501)	(1,085)
Financing Activities:		
Cash dividends paid on common stock	(512)	
Cash dividends paid on preferred stock	(13,827)	(13,828)
Net cash used in financing activities	(14,339)	(13,828)
Net (decrease) increase in cash on deposit with Harris N.A.	(83)	326
Cash on deposit with Harris N.A. at beginning of period	5,284	700
Cash on deposit with Harris N.A. at end of period	$ 5,201	$ 1,026

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

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HARRIS PREFERRED CAPITAL CORPORATION

NOTES TO CONSOLIDATED 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 N.A. (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, primarily U.S. treasury securities and securities collateralized with real estate mortgages. The Company holds its assets through a Maryland real estate investment trust subsidiary, Harris Preferred Capital Trust. Harris Capital Holdings, Inc., owns 100% of the Company s common stock. The Bank owns all common stock outstanding issued by Harris Capital Holdings, Inc.

The accompanying consolidated financial statements have been prepared by management from the books and records of the Company. 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 consolidated financial statements included in the Company s 2006 Form 10-K. Certain reclassifications were made to conform prior years financial statements to the current year s presentation. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission.

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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 re 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 Item 1A. Risk Factors in the Company s 2006 Form 10-K and 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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Results of Operations

Third Quarter 2007 Compared with Third Quarter 2006

The Company s net income for the third quarter of 2007 was $5.6 million, a 6% increase from the third quarter 2006 net income of $5.3 million. Earnings increased primarily because of increased interest income on earning assets.

Interest income on securities purchased under agreement to resell for the third quarter of 2007 was $1.0 million on an average balance of $80.8 million, with an annualized yield of 4.96%. During the same period in 2006, the interest income on securities purchased under agreement to resell was $1.1 million, on an average balance of $97.9 million, with an annualized yield of 4.45%. The decrease in income was attributable to lower balances, partially offset by higher yields. Third quarter 2007 interest income on the Notes totaled $89 thousand and yielded 6.4% on $5.6 million of average principal outstanding for the quarter compared to $111 thousand and a 6.4% yield on $6.9 million average principal outstanding for the third quarter of 2006. The decrease in income was attributable to a reduction in the Notes balance because of principal paydowns by customers in the Securing Mortgage Loans. Interest income on securities available-for-sale for the current quarter was $4.6 million resulting in a yield of 4.7% on an average balance of $393 million, compared to $4.2 million with a yield of 4.4% on an average balance of $382 million for the same period a year ago. The increase in interest income is primarily attributable to the portfolio of mortgage-backed securities generating a higher yield in the current quarter.

There were no Company borrowings during third quarter 2007 or 2006.

Third quarter 2007 operating expenses totaled $95 thousand, compared to $96 thousand in the third quarter of 2006. Loan servicing expenses totaled $5 thousand for the third quarter in 2007 and 2006. Advisory fees for the third quarter 2007 were $36 thousand compared to $32 thousand a year earlier. General and administrative expenses totaled $54 thousand, a decrease of $5 thousand from the same period in 2006 due to lower processing costs.

At September 30, 2007 and 2006, there were no Securing Mortgage Loans on nonaccrual status.

The Company classifies all securities as available-for-sale. The Company has no intent to sell specific securities, and the Company has the ability to hold all securities to maturity. Available-for-sale securities are reported at fair value with unrealized gains and losses included as a separate component of stockholders equity. At September 30, 2007, net unrealized losses on available-for-sale securities were $6.5 million compared to $9.1 million of unrealized losses on September 30, 2006 and $8.1 million of unrealized losses at December 31, 2006. The unrealized loss positions at September 30, 2007 and 2006 and December 31, 2006 were attributable to changes in interest rates and not to lowered credit quality of individual securities; therefore management believes these unrealized losses are temporary.

In making a determination of temporary vs. other-than-temporary impairment of an investment, a major consideration of management is whether the Company will be able to collect all amounts due according to the contractual terms of the investment. Such a determination involves estimation of the outcome of future events as well as knowledge and experience about past and current events. Factors considered include the following: whether the fair value is significantly below cost and the decline is attributable to specific adverse conditions in an industry or geographic area; the period of time the decline in fair value has existed; if an outside rating agency has downgraded the investment; if dividends have been reduced or eliminated; if scheduled interest payments have not been made and finally, whether the financial condition of the issuer has deteriorated. In addition, it may be necessary for the Company to demonstrate its ability and intent to hold a debt security to maturity.

Nine Months Ended September 30, 2007 compared with September 30, 2006

The Company s net income for the nine months ended September 30, 2007 was $16.7 million. This represented a $1.2 million increase or 8% from 2006 earnings for the nine month period. Earnings increased primarily because of an increase in interest income on earning assets.

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Interest income on securities purchased under agreement to resell for the nine months ended September 30, 2007 was $2.9 million, on an average balance of $78 million, with an average rate of 4.9%. During the same period in 2006, the interest income on securities purchased under agreement to resell was $3.4 million on an average balance of $99 million, with an average rate of 4.5%. The decrease in interest income was attributable to lower balances, partially offset by higher yields. Interest income on the Notes for the nine months ended September 30, 2007 totaled $278 thousand, yielding 6.4% on $5.8 million of average principal outstanding compared to $360 thousand of income yielding 6.4% on $7.5 million of average principal outstanding for the same period in 2006. 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 was $7 million for the nine months ended September 30, 2007 and $9 million for the same period in 2006. There were no Company borrowings during either period. Interest income on securities available-for-sale for the nine months ended September 30, 2007 was $13.9 million resulting in a yield of 4.6% on an average balance of $399 million, compared to $12.1 million resulting in a yield of 4.4% on an average balance of $371 million a year ago. The increase in interest income from available-for-sale securities is primarily attributable to growth in the portfolio of mortgage-backed securities.

Operating expense for the nine months ended September 30, 2007 totaled $298 thousand, a decrease of $35 thousand from a year ago. Loan servicing expenses for the nine months ended September 30, 2007 totaled $14 thousand, a decrease of $3 thousand or 18% from 2006. 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 nine months ended September 30, 2007 were $103 thousand compared to $93 thousand a year ago. The increase is due to increased costs with the day-to-day operations of the Company. General and administrative expenses totaled $181 thousand, a decrease of $42 thousand or 19% from the same period in 2006 as a result of reduced costs for printing, insurance and processing costs.

On October 1, 2007, the Company paid a cash dividend of $0.46094 per share on outstanding Preferred Shares to the stockholders of record on September 15, 2007 as declared on August 29, 2007. On September 30, 2006, the Company paid a cash dividend of $0.46094 per share on outstanding Preferred Shares to the stockholders of record on September 15, 2006, as declared on August 30, 2006. On September 12, 2007, the Company paid a cash dividend of $512 thousand declared on August 29, 2007 on the outstanding common shares to the stockholder of record on September 1, 2007. The Company made the election under Internal Revenue Code Section 858(a) to treat this distribution as having been made during 2006.

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.

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The Company anticipates that cash and cash equivalents on hand and the cash flow from the Notes and mortgage-backed treasury securities will provide adequate liquidity for its operating, investing and financing needs including the capacity to continue preferred dividend payments on an uninterrupted basis.

As presented in the accompanying Consolidated Statements of Cash Flows, the primary source of funds in addition to $16.8 million provided from operations during the nine months ended September 30, 2007, was $255 million provided from the maturities of securities available-for-sale. In the prior period ended September 30, 2006, the primary sources of funds other than $15.2 million from operations were $322 million provided from the maturities of securities available-for-sale and $8.4 million resulting from a decrease in securities purchased under agreement to resell. The primary uses of funds for the nine months ended September 30, 2007 were $259 million for purchases of securities available-for-sale and $13.8 million in preferred stock dividends paid and $512 thousand in common stock dividends paid. In the prior period ended September 30, 2006, the primary uses of funds were $333 million for purchases of securities available-for-sale and $13.8 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, 2006.

Accounting Pronouncements

The Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements, in September 2006. The Statement provides guidance for using fair value to measure assets and liabilities. It clarifies the methods for measuring fair value, establishes a fair value hierarchy and requires expanded disclosure. SFAS 157 applies when other standards require or permit assets or liabilities to be measured at fair value and is effective for fiscal years beginning after November 15, 2007. The Company is in the process of assessing the impact of adopting this Statement on its financial position and results of operations.

The FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115, in February 2007. The Statement permits entities to choose to measure certain eligible items at fair value at specified election dates. Although most of the provisions are elective, the amendment to SFAS 115 applies to all entities with available-for-sale and trading securities. SFAS 159 is effective as of the beginning of the fiscal year that begins after November 15, 2007. The Company is in the process of assessing the impact of adopting this Statement on its financial position and results of operations.

Other Matters

As of September 30, 2007, the Company believes that it is in full compliance with the REIT tax rules, and expects to qualify as a non-taxable REIT under the provisions of the Internal Revenue Code. The Company expects to meet all REIT requirements regarding the ownership of its stock and anticipates meeting the annual distribution requirements.

On June 8, 2007, Standard & Poor s Ratings Services lowered its short and long-term counterparty ratings on Bank of Montreal (the Company s ultimate parent). At the same time, Standard & Poor s removed the ratings from Creditwatch with negative implications, where they were placed May 17, 2007. The outlook is stable. As part of this action, the Standard & Poor s rating for the preferred stock of the Company was lowered from A to A− .

Financial Statements of Harris N.A.

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 N.A. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CONDITION

	September 30 2007 (unaudited)	December 31 2006 audited	September 30 2006 (unaudited)
	(in thousands except share data)		
ASSETS			
Cash and demand balances due from banks	$ 1,362,213	$ 1,084,959	$ 1,170,152
Money market assets:			
Interest-bearing deposits at banks	936,792	944,116	932,474
Federal funds sold and securities purchased under agreement to resell	769,393	672,760	1,378,494
Securities available-for-sale (including $5.82 billion, $5.15 billion, and $5.83 billion of securities pledged as collateral for repurchase agreements at September 30, 2007, December 31, 2006 and September 30, 2006, respectively)	11,178,434	10,713,910	8,393,139
Trading account assets	207,927	293,353	205,776
Loans	25,273,204	25,402,554	25,395,031
Allowance for loan losses	(315,640)	(322,742)	(323,687)
Net loans	$ 24,957,564	$ 25,079,812	$ 25,071,344
Loans held for sale	50,279	34,451	26,966
Premises and equipment	490,297	474,073	473,780
Bank-owned insurance	1,236,095	1,168,744	1,157,696
Goodwill and other intangible assets	550,866	395,140	400,513
Other assets	1,213,403	912,004	1,414,115
Total assets	$ 42,953,263	$ 41,773,322	$ 40,624,449
LIABILITIES			
Deposits in domestic offices noninterest-bearing	$ 5,706,170	$ 6,232,744	$ 5,833,858
interest-bearing	23,376,406	22,855,715	20,666,415
Deposits in foreign offices interest-bearing	855,978	1,030,838	1,186,451
Total deposits	$ 29,938,554	$ 30,119,297	$ 27,686,724
Federal funds purchased	327,330	476,000	297,200
Securities sold under agreement to repurchase	4,068,896	3,475,839	4,080,622
Short-term borrowings	690,101	1,261,679	1,959,570
Short-term senior notes	410,000	100,000	100,000
Accrued interest, taxes and other expenses	278,457	205,942	218,493
Accrued pension and post-retirement	165,508	170,853	99,627
Other liabilities	704,742	1,078,049	1,307,613
Minority interest preferred stock of subsidiary	250,000	250,000	250,000
Long-term notes senior	2,096,500	996,500	996,500

Long-term notes subordinated	292,750	292,750	292,750
Total liabilities	$ 39,222,838	$ 38,426,909	$ 37,289,099
STOCKHOLDER S EQUITY			
Common stock ($10 par value); authorized 40,000,000 shares; issued and outstanding 15,514,761, 14,303,361 and 14,303,361 shares at September 30, 2007, December 31, 2006 and September 30, 2006, respectively	$ 155,148	$ 143,034	$ 143,034
Surplus	1,779,230	1,489,521	1,487,188
Retained earnings	1,887,690	1,811,497	1,759,656
Accumulated other comprehensive loss	(91,643)	(97,639)	(54,528)
Total stockholder s equity	$ 3,730,425	$ 3,346,413	$ 3,335,350
Total liabilities and stockholder s equity	$ 42,953,263	$ 41,773,322	$ 40,624,449

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

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HARRIS N.A. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Quarter Ended September 30, 2007	Quarter Ended September 30, 2006	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
	(in thousands)		(in thousands)	
Interest Income				
Loans	$ 411,104	$ 406,725	$ 1,230,717	$ 1,165,732
Money market assets:				
Deposits at banks	5,680	3,531	15,772	10,200
Federal funds sold and securities purchased under agreement to resell	13,252	16,432	23,178	26,492
Trading accounts	2,651	1,731	7,149	5,730
Securities available-for-sale:				
U.S. Treasury and federal agency	115,986	79,275	344,553	191,732
State and municipal	9,606	5,959	26,097	17,051
Other	6,313	5,154	18,926	16,112
Total interest income	$ 564,592	$ 518,807	$ 1,666,392	$ 1,433,049
Interest Expense				
Deposits	261,062	192,398	736,328	517,205
Short-term borrowings	53,714	89,785	200,032	218,898
Short-term notes senior	5,678	4,710	17,999	16,465
Long-term notes senior	13,480	4,609	41,508	13,828
Long-term notes subordinated	20,341	13,797	28,831	22,340
Minority interest-dividends on preferred stock of subsidiary	4,609	4,277	13,828	11,727
Total interest expense	$ 358,884	$ 309,576	$ 1,038,526	$ 800,463
Net Interest Income	205,708	209,231	627,866	632,586
Provision for loan losses	13,000	6,891	26,800	18,198
Net Interest Income after Provision for Loan Losses	$ 192,708	$ 202,340	$ 601,066	$ 614,388
Noninterest Income				
Trust and investment management fees	23,044	20,405	69,030	59,385
Money market and bond trading	1,435	5,408	8,521	11,135
Foreign exchange	550	1,000	2,625	3,400
Service charges and fees	42,661	39,863	124,438	117,860
Net securities gains (losses)	142	25,892	(5,683)	28,244
Bank-owned insurance	14,428	12,392	39,214	33,832

Letter of credit fees	4,203	4,509	13,985	14,251
Syndication fees	267	8,456	1,343	14,321
Gains (losses) on sales of fixed assets	1,058	(970)	973	(824)
Other	15,531	10,846	42,824	37,295
Total noninterest income	$ 103,319	$ 127,801	$ 297,270	$ 318,899
Noninterest Expenses				
Salaries and other compensation	90,241	94,320	270,654	270,368
Pension, profit sharing and other employee benefits	26,504	25,904	86,627	84,358
Net occupancy	21,994	21,489	65,230	60,272
Equipment	16,215	15,915	48,520	48,032
Marketing	9,881	11,515	27,906	31,761
Communication and delivery	6,993	6,455	20,841	19,079
Expert services	7,005	8,930	21,391	26,135
Contract programming	5,868	9,434	21,615	23,508
Intercompany services	11,428	13,677	34,615	43,094
Restructuring charge (note 4)			13,376	
Other	34,617	30,709	92,581	88,228
Amortization of intangibles	6,332	5,385	19,115	16,147
Total noninterest expenses	$ 237,078	$ 243,733	$ 722,471	$ 710,982
Income before income taxes	58,949	86,408	175,865	222,305
Applicable income taxes	12,020	25,807	36,375	66,198
Net Income	$ 46,929	$ 60,601	$ 139,490	$ 156,107

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

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HARRIS N.A. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2007	**2006**	**2007**	**2006**
	(in thousands)			
Net income	$ 46,929	$ 60,601	$ 139,490	$ 156,107
Other comprehensive income:				
Cash flow hedges:				
Net unrealized loss on derivative instruments, net of tax benefit for the quarter of ($7,160) in 2007 and ($2,103) in 2006 and net of tax benefit for the year-to-date period of ($7,305) in 2007 and ($2,469) in 2006	(13,295)	(3,756)	(13,568)	(4,687)
Less reclassificaiton adjustment for realized loss included in net income, net of tax benefit for the quarter of ($1,063) in 2007 and ($1,138) in 2006 and net of tax benefit for the year-to-date period of ($3,246) in 2007 and ($3,120) in 2006	1,973	2,113	6,029	5,795
Pension and other postretirement benefit adjustments:				
Net unrealized gain on pension and other postretirement benefits, net of tax expense for the quarter of $717 in 2007 and $0 in 2006 and net of tax expense for the year-to-date period of $2,149 in 2007 and $0 in 2006	1,330		3,990	
Unrealized gain on available-for-sale securities:				
Net unrealized holding gain arising during the period, net of tax expense for the quarter of $23,929 in 2007 and $24,809 in 2006 and net of tax expense for the year-to-date period of $3,229 in 2007 and $18,269 in 2006	44,440	44,896	5,851	32,710
Less reclassification adjustment for realized (gain) loss included in net income, net of tax expense for the quarter of $50 in 2007 and $9,062 in 2006 and net of tax (benefit) expense for the year-to-date period of ($1,989) in 2007 and $9,885 in 2006	(92)	(16,830)	3,694	(18,359)
Other comprehensive income	34,356	26,423	5,996	15,459
Comprehensive income	$ 81,285	$ 87,024	$ 145,486	$ 171,566

The accompanying notes to consolidated financial statements are an integral pert of these statements.

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HARRIS N.A. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDER S EQUITY
(Unaudited)

	2007	2006
	(in thousands)	
Balance at January 1	$ 3,346,413	$ 3,073,553
Net income	139,490	156,107
Contributions to capital surplus	278,260	148,001
Issuance of common stock	12,114	2,870
Stock option exercise	3,191	1,308
Tax benefit from stock option exercise	7,961	10,052
Dividends ($4.22 in 2007 and $5.23 in 2006 per common share)	(63,000)	(72,000)
Other comprehensive income	5,996	15,459
Balance at September 30	$ 3,730,425	$ 3,335,350

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

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HARRIS N.A. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September 30, 2007	2006
	(in thousands)	
Operating Activities:		
Net Income	$ 139,490	$ 156,107
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Provision for loan losses	26,800	18,198
Depreciation and amortization, including intangibles	25,851	57,890
Deferred tax (benefit) expense	(10,000)	66,198
Tax benefit from stock options exercise	7,961	10,052
Net securities losses (gains)	5,683	(28,244)
Increase in bank-owned insurance	(32,152)	(30,423)
Trading account net cash (purchases) sales	(530,621)	316,388
Increase in accrued interest receivable	(15,163)	(26,024)
Increase in accrued interest payable	59,312	19,795
Origination of loans held for sale	(254,531)	(196,595)
Proceeds from sale of loans held for sale	241,184	203,236
Net gain on loans held for sale	(2,481)	(1,243)
Net (decrease) increase in pension and post retirement benefits	(3,504)	2,050
Net decrease in undistributed loan principal	(5,749)	(4,855)
Recoveries on charged-off loans	24,915	21,295
Net (increase) decrease in marked to market hedging derivatives	(27,862)	14,264
Other, net	(15,833)	(15,582)
Net cash (used in) provided by operating activities	$ (366,700)	$ 582,507
Investing Activities:		
Net decrease in interest-bearing deposits at banks	70,933	59,622
Net increase in Federal funds sold and securities purchased under agreement to resell	(96,633)	(1,119,579)
Proceeds from sales of securities available-for-sale	7,768,788	2,875,170
Proceeds from maturities of securities available-for-sale	14,928,974	5,535,986
Purchases of securities available-for-sale	(22,889,426)	(10,172,950)
Net decrease (increase) in loans	938,726	(1,094,677)
Purchases of premises and equipment	(35,439)	(70,337)
Net (gain) loss on sale of premises and equipment	(973)	824
Acquisition, net of cash acquired	19,602	
Net cash provided by (used in) investing activities	$ 704,552	$ (3,985,941)

Financing Activities:				
Net (decrease) increase in deposits		(1,129,344)		2,158,502
Net increase in Federal funds purchased and securities sold under agreement to repurchase		290,973		961,339
Net decrease in short-term borrowings		(571,578)		(78,200)
Net increase in short-term senior notes		1,310,000		1,700,000
Repayment of short-term senior notes		(1,000,000)		(2,400,000)
Proceeds from issuance of long-term senior notes		1,100,000		746,500
Proceeds from issuance of common stock				150,000
Cash dividends paid on common stock		(63,000)		(72,000)
Net proceeds from stock options exercise		3,191		1,308
Excess tax expense from stock options exercise		(840)		(930)
Net cash (used in) provided by financing activities	$	(60,598)	$	3,166,519
Net increase (decrease) in cash and demand balances due from banks		277,254		(236,915)
Cash and demand balances due from banks at January 1		1,084,959		1,407,067
Cash and demand balances due from banks at September 30	$	1,362,213	$	1,170,152

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

HARRIS N.A. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

Harris N.A. (the Bank) is a wholly-owned subsidiary of Harris Bankcorp, Inc. (Bankcorp), a wholly-owned subsidiary of Harris Financial Corp., a wholly-owned U.S. 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.

On February 17, 2006 Bankcorp merged one of its bank subsidiaries, New Lenox State Bank, with and into Harris N.A. This transaction was recorded at its carrying value and prior year financial statements have been restated to include operations from the time New Lenox State Bank was initially acquired by Bankcorp.

On August 26, 2006 Bankcorp consolidated one of its bank subsidiaries, Mercantile National Bank of Indiana, with and into the Bank. This transaction was recorded at its carrying value and prior year financial statements have been restated to include operations from the time Mercantile National Bank of Indiana was initially acquired by Bankcorp.

On May 12, 2007 Bankcorp consolidated one of its bank subsidiaries, First National Bank and Trust (FNBT), with and into the Bank. This transaction was recorded at its carrying value. Bankcorp acquired FNBT on January 4, 2007.

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 is not expected to 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 for the nine months ended September 30 totaled $977.6 million and $780.7 million in 2007 and 2006, respectively. Cash income tax payments over the same periods totaled $79.3 million and $88.6 million, respectively.

4. Restructuring Charge

The Bank recorded a restructuring charge of $13.4 million for the nine months ended September 30, 2007, which is part of a $15.1 million restructuring charge for Harris Bankcorp, Inc., in the Consolidated Statement of Income. The objectives of the restructuring are to enhance customer service by directing spending and resources on front-line sales and service improvements, creating more effective processes and systems across the Bank and continuing accelerating the pace of the Bank s growth.

The charge relates to the elimination of approximately 200 positions in primarily non-customer-facing areas of the Bank across all support functions and business groups. Of the charge, $10.7 million relates to severance-related costs and $2.7 million is associated with premises-related charges.

Premises related charges include lease cancellation payments for those locations where we have legally extinguished our lease obligations as well as the carrying value of abandoned assets in excess of their fair market value.

At September 30, 2007, $3.4 million remained in other liabilities on the Consolidated Statement of Condition related to amounts to be paid in future periods.

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HARRIS N.A. AND SUBSIDIARIES

FINANCIAL REVIEW

Third Quarter 2007 Compared with Third Quarter 2006

Summary

The Bank s third quarter 2007 net income was $46.9 million, down $13.7 million or 22.6 percent from the third quarter 2006. Return on equity was 5.12 percent in the current quarter, compared to 7.30 percent in last year s third quarter. Return on assets was 0.44 percent compared to 0.62 percent a year ago.

Third quarter 2007 net interest income was $205.7 million, down $3.5 million or 1.7 percent from $209.2 million in the third quarter of 2006. Average earning assets increased 10.4 percent to $38.7 billion from $35.0 billion in 2006, due in part to an increase of $2.9 billion in securities available for sale. Net interest margin decreased to 2.24 percent in the third quarter of 2007 from 2.47 percent in the third quarter of 2006, primarily reflecting a flat yield curve depressing spreads and the impact of greater reliance on higher-cost wholesale funding sources and higher costs of interest-bearing deposits. This was somewhat offset by the growth in volume of and improved yield on securities available for sale, particularly U.S. government agencies.

Third quarter 2007 provision for loan losses was $13.0 million compared to $6.9 million in the third quarter of 2006. Net charge-offs decreased to $6.7 million from $9.1 million in the prior year, reflecting higher recoveries and lower charge-offs primarily in the commercial loan portfolio. The provision for loan losses takes into account portfolio quality and management s estimate of probable loan losses.

Third quarter 2007 non-interest income was $103.3 million, down $24.5 million or 19.2 percent from the third quarter of 2006. The decrease was primarily attributable to a $25.8 million decline in net securities gains, $8.2 million decrease in syndication fees and $4.0 million lower money market and bond trading profits. The decreases were partially offset by $2.6 million in higher trust and investment management fees, a $2.0 million increase in bank-owned insurance income, a $2.8 million increase in service charges and fees, a $2.0 million increase on gains (losses) on sales of fixed assets and growth in other non-interest income, which included $2.9 million from loan collateral sold and $2.1 million increase in equity securities gains.

Third quarter 2007 non-interest expenses were $237.1 million, down $6.7 million or 2.7 percent from the third quarter of 2006. In January 2007 the Bank acquired FNBT. Excluding approximately $9.9 million of non-interest expenses associated with FNBT, expenses decreased $16.5 million or 6.8 percent from the same period in 2006. These decreases primarily reflect the effects of the restructuring initiative on current business activities (note 4), largely in salaries and other compensation. Other non-interest expenses decreases include a decline of $3.0 million in contract programming costs, decrease of $2.4 in marketing costs, $2.2 million reduction in inter-company services costs and $1.6 million reduction in expert services. The decreases were partially offset by a $1.4 million increase in other non-interest expenses due primarily to wholesale lockbox services outsourcing. Income tax expense decreased $13.8 million, reflecting lower pretax income from the third quarter of 2006.

Nonperforming assets at September 30, 2007 were $269.3 million or 1.07 percent of total loans, up from $163.8 million or 0.64 percent at December 31, 2006 and $130.7 million or 0.51 percent from the third quarter of 2006. At September 30, 2007, the allowance for loan losses was $315.6 million, equal to 1.25 percent of loans outstanding, compared to $323.7 million or 1.27 percent of loans outstanding at the end of third quarter 2006. As a result, the ratio of the allowance for loan losses to nonperforming assets decreased from 247.6 percent at September 30, 2006 to 117.2 percent at September 30, 2007.

At September 30, 2007 consolidated stockholder s equity of the Bank amounted to $3.73 billion, up from $3.35 billion at December 31, 2006. No Common stock was issued during the third quarter 2007. The Bank declared and paid $20.0 million in dividends on common stock in both the third quarter of 2007 and 2006.

At September 30, 2007, Tier 1 capital of the Bank amounted to $3.53 billion, up from $3.24 billion one year earlier. The regulatory leverage capital ratio was 8.33 percent for the third quarter of 2007 compared to 8.26 percent in the same quarter of 2006. The Bank s capital ratio exceeds the prescribed regulatory minimum for banks.

The Bank s September 30, 2007 Tier 1 and total risk-based capital ratios were 10.50 percent and 12.32 percent compared to respective ratios of 9.73 percent and 11.58 percent at September 30, 2006.

Nine Months ended September 30, 2007 Compared with Nine Months ended September 30, 2006

Summary

The Bank s net income for the nine months ended September 30, 2007 was $139.5 million, down $16.6 million or 10.6 percent from the same period last year. Return on equity was 5.12 percent in the current year, compared to 6.34 percent from last year. Return on assets was 0.44 percent compared to 0.54 percent a year ago.

Nine months ended September 30, 2007 net interest income was $627.9 million, down $4.7 million or 0.7 percent from $632.6 million from last year. Average earning assets increased 12.1 percent to $38.2 billion from $34.1 billion in 2006, due in part to an increase of $3.5 billion in securities available for sale. Net interest margin decreased to 2.31 percent in 2007 from 2.57 percent in the same period in 2006, primarily reflecting a flat yield curve depressing spreads and the impact of increased volume and yield on interest-bearing deposits. This was somewhat offset by higher interest income due to the growth in volume of and improved yield on securities available for sale, particularly US government agencies.

Year-to-date 2007 provision for loan losses was $26.8 million compared to $18.2 million in 2006. Net charge-offs increased to $38.8 million from $25.9 million in the prior year, reflecting higher write-offs primarily in the commercial loan portfolio. The provision for loan losses takes into account portfolio quality and management s estimate of probable loan losses.

Nine months ended September 30, 2007 non-interest income was $297.3 million, down $21.6 million or 6.8 percent from last year. This was primarily attributable to a $33.9 million decline in net securities gains, a $13.0 million decrease in syndication fees and $2.6 million lower money market and bond trading profits. The decreases were partially offset by a $9.6 million increase in trust and investment management fees, $5.4 million higher in bank-owned insurance income, a $6.6 million increase in service charges and fees, a $1.8 million higher gains (losses) on sales of fixed assets and growth in other non-interest income, which included $2.9 million from loan collateral sold and $2.1 million higher in equity securities gains.

Nine months ended September 30, 2007 non-interest expenses were $722.5 million, up $11.5 million or 1.6 percent from last year. The main drivers were attributable to a restructuring charge of $13.4 million (note 4), largely in salaries and other compensation and approximately $39.5 million due to the acquisition of FNBT in January 2007. Excluding the restructuring charge and the acquisition of FNBT, expenses decreased $41.4 million or 5.8 percent from the same period in 2006. The decrease primarily reflects the effects of the restructuring initiative on current business activities. Excluding restructuring and FNBT, the Bank had a $8.5 million reduction in inter-company services costs, a $7.0 million reduction in contract programming, $5.6 million lower in marketing costs and a $5.6 million reduction in expert services expenses, which was due largely to the outsourcing of our wholesale lockbox services. The decreases were partially offset by an increase of $2.6 million in net occupancy expenses. Income tax expense decreased $29.8 million, reflecting lower pretax income from the same period 2006.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

See Liquidity Risk Management and Market Risk Management under Management s Discussion and Analysis of Financial Condition and Results of Operations on page 6.

Item 4. Controls and Procedures

As of September 30, 2007, Paul R. Skubic, the Chairman of the Board, Chief Executive Officer and President of the Company, and Pamela C. Piarowski, the Chief Financial Officer of the Company, evaluated the effectiveness of the disclosure controls and procedures of the Company and concluded that these disclosure controls and procedures are effective to ensure that material information required to be included in this Report has been recorded, processed, summarized and made known to them in a timely fashion, as appropriate to allow timely decisions regarding disclosures. There was no change in the Company s internal control over financial reporting identified in connection with such evaluations that occurred during the quarter ended September 30, 2007 that has materially affected or is reasonably likely to materially affect, the Company s internal control over financial reporting.

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Part II. OTHER INFORMATION

Items 1, 1A, 2, 3, 4 and 5 of Part II are being omitted from this Report because such items are not applicable to the reporting period.

Item 6. Exhibits

31.1 Certification of Pamela C. Piarowski pursuant to rule 13a-14(a)

31.2 Certification of Paul R. Skubic pursuant to rule 13a-14(a)

32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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SIGNATURES

Pursuant to the requirements 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 13th day of November 2007.

/s/ Paul R. Skubic
Paul R. Skubic
Chairman of the Board and President

/s/ Pamela C. Piarowski
Pamela C. Piarowski
Chief Financial Officer