DOWNEY FINANCIAL CORP
Form 10-Q
August 05, 2002

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED

For the quarterly period ended JUNE 30, 2002

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM __________ TO __________

Commission File Number 1-13578
DOWNEY FINANCIAL CORP.
(Exact name of registrant as specified in its charter)

DELAWARE	33-0633413
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

3501 JAMBOREE ROAD, NEWPORT BEACH, CA	92660
(Address of principal executive office)	(Zip Code)

Registrant's telephone number, including area code (949) 854-0300

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

Title of each class	Name of each exchange on which registered
COMMON STOCK, $0.01 PAR VALUE	NEW YORK STOCK EXCHANGE PACIFIC 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 X No__

At June 30, 2002, 28,235,022 shares of the Registrant's Common Stock, $0.01 par value were outstanding.

DOWNEY FINANCIAL CORP.

JUNE 30, 2002 QUARTERLY REPORT ON FORM 10-Q

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PART I - FINANCIAL INFORMATION

DOWNEY FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Dollars in Thousands, Except Per Share Data)	(Unaudited) June 30, 2002
ASSETS	
Cash	$ 117,788
Federal funds	16,401
Cash and cash equivalents	134,189
U.S. Treasury securities, agency obligations and other investment securities available for sale, at fair value	292,832
Municipal securities held to maturity, at amortized cost (estimated fair value of $6,373 at June 30, 2002 and December 31, 2001 and $6,534 at June 30, 2001)	6,387
Mortgage loans purchased under resale agreements	--

Loans held for sale, at lower of cost or fair value	381,465
Mortgage-backed securities available for sale, at fair value	58,122
Loans receivable held for investment	9,846,446
Investments in real estate and joint ventures	40,283
Real estate acquired in settlement of loans	13,528
Premises and equipment	113,417
Federal Home Loan Bank stock, at cost	114,452
Mortgage servicing rights, net	59,771
Other assets	69,311
	$ 11,130,203
LIABILITIES AND STOCKHOLDERS' EQUITY	
Deposits	$ 8,690,558
Federal Home Loan Bank advances and other borrowings	1,413,607
Accounts payable and accrued liabilities	64,614
Deferred income taxes	54,118
Total liabilities	10,222,897
Company obligated mandatorily redeemable capital securities of subsidiary trust holding solely junior subordinated debentures of the Company ("Capital Securities")	120,000
STOCKHOLDERS' EQUITY	
Preferred stock, par value of $0.01 per share; authorized 5,000,000 shares; outstanding none	--
Common stock, par value of $0.01 per share; authorized 50,000,000 shares; outstanding 28,235,022 shares at June 30, 2002, 28,213,048 shares at December 31, 2001 and 28,211,048 shares at June 30, 2001	282
Additional paid-in capital	93,792
Accumulated other comprehensive income (loss)	236
Retained earnings	692,996
Total stockholders' equity	787,306
	$ 11,130,203

See accompanying notes to consolidated financial statements.

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DOWNEY FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED)

(Dollars in Thousands, Except Per Share Data)	Three Months Ended June 30, 2002	200
INTEREST INCOME		
Loans receivable	$ 148,448	$ 203,
U.S. Treasury securities and agency obligations	2,163	4,
Mortgage-backed securities	942	
Other investments	1,872	3,
Total interest income	153,425	211,

INTEREST EXPENSE		
Deposits	60,397	114,
Borrowings	14,859	17,
Capital securities	3,041	3,
Total interest expense	78,297	134,
NET INTEREST INCOME	75,128	76,
PROVISION FOR (REDUCTION OF) LOAN LOSSES	(1,106)	
Net interest income after provision for (reduction of) loan losses	76,234	75,
OTHER INCOME, NET		
Loan and deposit related fees	11,396	14,
Real estate and joint ventures held for investment, net	1,016	
Secondary marketing activities:		
Loan servicing loss, net	(15,617)	(2,
Net gains on sales of loans and mortgage-backed securities	6,896	8,
Net gains on sales of mortgage servicing rights	12	
Net gains on sales of investment securities	19	
Other	380	
Total other income, net	4,102	22,
OPERATING EXPENSE		
Salaries and related costs	28,315	24,
Premises and equipment costs	7,754	6,
Advertising expense	1,582	1,
Professional fees	233	1,
SAIF insurance premiums and regulatory assessments	762	
Other general and administrative expense	6,350	5,
Total general and administrative expense	44,996	40,
Net operation of real estate acquired in settlement of loans	27	(
Amortization of excess cost over fair value of branch acquisitions	114	
Total operating expense	45,137	40,
INCOME BEFORE INCOME TAXES	35,199	57,
Income taxes	14,890	24,
NET INCOME	$ 20,309	$ 33,
PER SHARE INFORMATION		
BASIC	$ 0.72	$ 1
DILUTED	$ 0.72	$ 1
CASH DIVIDENDS DECLARED AND PAID	$ 0.09	$ 0
Weighted average diluted shares outstanding	28,284,493	28,271,

See accompanying notes to consolidated financial statements.

DOWNEY FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(UNAUDITED)

(In Thousands)	Three Months Ende June 30, 2002	2001
NET INCOME	$ 20,309	$ 33,4
OTHER COMPREHENSIVE INCOME (LOSS), NET OF INCOME TAXES (BENEFITS)		
Unrealized gains (losses) on securities available for sale:		
U.S. Treasury securities, agency obligations and other investment securities available for sale, at fair value	811	(1
Mortgage-backed securities available for sale, at fair value	1,862	
Less reclassification of realized gains included in net income	(11)	(
Unrealized gains (losses) on cash flow hedges:		
Net derivative instruments	(3,108)	2,0
Less reclassification of realized (gains) losses included in net income	1,970	(6
Total other comprehensive income, net of income taxes	1,524	1,2
COMPREHENSIVE INCOME	$ 21,833	$ 34,6

See accompanying notes to consolidated financial statements.

DOWNEY FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

(In Thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES	
Net income	$
Adjustments to reconcile net income to net cash used for operating activities:	
Depreciation and amortization	
Provision for losses on loans, real estate acquired in settlement of loans, investments in real estate and joint ventures, mortgage servicing rights and other assets	
Net gains on sales of loans and mortgage-backed securities, mortgage servicing rights, investment securities, real estate and other assets	
Net change in interest capitalized on loans (negative amortization)	
Federal Home Loan Bank stock dividends	
Loans originated for sale	(2,
Proceeds from sales of loans held for sale, including those sold via mortgage-backed securities	2,
Other, net	
Net cash provided by (used for) operating activities	

CASH FLOWS FROM INVESTING ACTIVITIES	
Proceeds from sales of:	
U.S. Treasury securities, agency obligations and other investment securities available for sale	
Wholly owned real estate and real estate acquired in settlement of loans	
Proceeds from maturities of U.S. Treasury securities, agency obligations and other investment securities available for sale	
Purchase of:	
U.S. Treasury securities, agency obligations and other investment securities available for sale	(
Mortgage loans under resale agreements	
Loans receivable held for investment	
Premises and equipment	
Originations of loans receivable held for investment (net of refinances of $338,946 at June 30, 2002 and $377,262 at June 30, 2001)	(1,
Principal payments on loans receivable held for investment and mortgage-backed securities available for sale	1,
Net change in undisbursed loan funds	
Investments in real estate held for investment	
Other, net	
Net cash provided by (used for) investing activities	(

See accompanying notes to consolidated financial statements.

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DOWNEY FINANCIAL CORP. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)

(UNAUDITED)

	Six Month	
	June	
(In Thousands)	2002	
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	$ 70,992	$
Proceeds from Federal Home Loan Bank advances and other borrowings	2,213,400	
Repayments of Federal Home Loan Bank advances and other borrowings	(2,322,505)	
Proceeds from exercise of stock options	392	
Cash dividends	(5,080)	
Net cash used for financing activities	(42,801)	
Net increase (decrease) in cash and cash equivalents	(8,891)	
Cash and cash equivalents at beginning of period	143,080	
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 134,189	$
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	$ 160,925	$
Income taxes	18,509	
Supplemental disclosure of non-cash investing:		
Loans transferred to held for investment from held for sale	2,015	
Loans exchanged for mortgage-backed securities	2,169,126	

Real estate acquired in settlement of loans	12,973
Loans to facilitate the sale of real estate acquired in settlement of loans	8,275

See accompanying notes to consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE (1) - BASIS OF FINANCIAL STATEMENT PRESENTATION

In the opinion of Downey Financial Corp. and subsidiaries ("Downey," "we," "us" and "our"), the accompanying consolidated financial statements contain all adjustments (consisting of only normal recurring accruals) necessary for a fair presentation of Downey's financial condition as of June 30, 2002, December 31, 2001 and June 30, 2001, the results of operations and comprehensive income for the three months and six months ended June 30, 2002 and 2001, and changes in cash flows for the six months ended June 30, 2002 and 2001. Certain prior period amounts have been reclassified to conform to the current period presentation.

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial statements and are in compliance with the instructions for Form 10-Q and therefore do not include all information and footnotes necessary for a fair presentation of financial condition, results of operations, comprehensive income and cash flows. The following information under the heading Management's Discussion and Analysis of Financial Condition and Results of Operations is written with the presumption that the interim consolidated financial statements will be read in conjunction with Downey's Annual Report on Form 10-K for the year ended December 31, 2001, which contains among other things, a description of the business, the latest audited consolidated financial statements and notes thereto, together with Management's Discussion and Analysis of Financial Condition and Results of Operations as of December 31, 2001 and for the year then ended. Therefore, only material changes in financial condition and results of operations are discussed in the remainder of Part I.

NOTE (2) - EARNINGS PER SHARE

Earnings per share is calculated on both a basic and diluted basis. Basic earnings per share excludes dilution and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted from issuance of common stock that then shared in earnings.

The following table presents a reconciliation of the components used to derive basic and diluted earnings per share for the periods indicated.

	Three Months Ended June			
	2002			
	Net	Weighted Average Shares	Per Share	Net

(Dollars in Thousands, Except Per Share Data)	Income	Outstanding	Amount	Income
Basic earnings per share	$ 20,309	28,232,787	$ 0.72	$ 33,455
Effect of dilutive stock options	--	51,706	--	--
Diluted earnings per share	$ 20,309	28,284,493	$ 0.72	$ 33,455

	Six Months Ended June 3			
	2002			
(Dollars in Thousands, Except Per Share Data)	Net Income	Weighted Average Shares Outstanding	Per Share Amount	Net Income
Basic earnings per share	$ 57,623	28,222,918	$ 2.04	$ 59,319
Effect of dilutive stock options	--	54,915	--	--
Diluted earnings per share	$ 57,623	28,277,833	$ 2.04	$ 59,319

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NOTE (3) - BUSINESS SEGMENT REPORTING

The following table presents the operating results and selected financial data by major business segments for the periods indicated.

(In Thousands)	Banking	Real Estate Investment	Elimination
THREE MONTHS ENDED JUNE 30, 2002			
Net interest income	$ 75,115	$ 13	$ --
Reduction of loan losses	(1,106)	--	--
Other income	2,803	1,299	--
Operating expense	44,893	244	--
Net intercompany income (expense)	86	(86)	--
Income before income taxes	34,217	982	--
Income taxes	14,493	397	--
Net income	$ 19,724	$ 585	$ --
AT JUNE 30, 2002			
Assets:			
Loans and mortgage-backed securities	$ 10,286,033	$ --	$ --
Investments in real estate and joint ventures	--	40,283	--
Other	840,416	1,919	(38,448
Total assets	11,126,449	42,202	(38,448
Equity	$ 787,306	$ 38,448	$ (38,448
THREE MONTHS ENDED JUNE 30, 2001			

Net interest income	$ 76,236	$ 10	$ --
Provision for loan losses	431	--	--
Other income	21,211	1,072	--
Operating expense	38,863	1,278	--
Net intercompany income (expense)	84	(84)	--
Income (loss) before income taxes (benefit)	58,237	(280)	--
Income taxes (benefit)	24,618	(116)	--
Net income (loss)	$ 33,619	$ (164)	$ --
AT JUNE 30, 2001			
Assets:			
Loans and mortgage-backed securities	$ 9,981,213	$ --	$ --
Investments in real estate and joint ventures	--	19,950	--
Other	837,387	1,673	(18,307
Total assets	10,818,600	21,623	(18,307
Equity	$ 680,719	$ 18,307	$ (18,307

(In Thousands)	Banking	Real Estate Investment	Elimination
SIX MONTHS ENDED JUNE 30, 2002			
Net interest income	$ 155,055	$ 18	$ --
Provision for loan losses	341	--	--
Other income	30,865	4,590	--
Operating expense	89,899	466	--
Net intercompany income (expense)	179	(179)	--
Income before income taxes	95,859	3,963	--
Income taxes	40,578	1,621	--
Net income	$ 55,281	$ 2,342	$ --
SIX MONTHS ENDED JUNE 30, 2001			
Net interest income	$ 152,370	$ 38	$ --
Provision for loan losses	483	--	--
Other income	25,956	2,340	--
Operating expense	75,853	1,538	--
Net intercompany income (expense)	181	(181)	--
Income before income taxes	102,171	659	--
Income taxes	43,243	268	--
Net income	$ 58,928	$ 391	$ --

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NOTE (4) - MORTGAGE SERVICING RIGHTS

The following table summarizes the activity in our mortgage servicing rights and related allowance for the periods indicated and other related financial data.

Three Month

(Dollars in Thousands)	June 30, 2002	March 31, 2002	December 2001
Gross balance at beginning of period	$ 74,914	$ 65,630	$ 61,651
Additions	10,156	14,997	15,300
Amortization	(3,253)	(2,916)	(2,956
Sales of mortgage servicing rights	--	(35)	(4,916
Impairment write-down	(717)	(2,762)	(3,449
Gross balance at end of period	81,100	74,914	65,630
Allowance balance at beginning of period	6,333	8,735	24,144
Provision for (reduction of) impairment	15,713	360	(11,960
Impairment write-down	(717)	(2,762)	(3,449
Allowance balance at end of period	21,329	6,333	8,735
Total mortgage servicing rights, net	$ 59,771	$ 68,581	$ 56,895
Estimated fair value (1)	$ 59,771	$ 70,532	$ 58,047
Weighted average expected life (in months)	61	87	82
Custodial account earnings rate	3.82%	4.61%	4.36
Weighted average discount rate	9.10	9.13	9.16
AT PERIOD END			
Mortgage loans serviced for others:			
Total	$ 6,962,403	$ 6,408,812	$ 5,805,811
With capitalized mortgage servicing rights (1):			
Amount	6,807,306	6,196,137	5,379,513
Weighted average interest rate	6.80%	6.85%	6.97
Custodial escrow balances	$ 13,044	$ 6,103	$ 10,596

(In Thousands)	Six Months Ended June 30, 2002	Six Months Ended June 30, 2001
Gross balance at beginning of period	$ 65,630	$ 46,214
Additions	25,153	18,797
Amortization	(6,169)	(4,362)
Sales of mortgage servicing rights	(35)	(2,328)
Impairment write-down	(3,479)	(2,473)
Gross balance at end of period	81,100	55,848
Allowance balance at beginning of period	8,735	5,483
Provision for impairment	16,073	10,696
Impairment write-down	(3,479)	(2,473)
Allowance balance at end of period	21,329	13,706
Total mortgage servicing rights, net	$ 59,771	$ 42,142

Key assumptions, which vary due to changes in market interest rates and are

used to determine the fair value of our mortgage servicing rights, include: expected prepayment speeds, which impact the average life of the portfolio; the earnings rate on custodial accounts, which impact the value of custodial accounts; and the discount rate used in valuing future cash flows. The table below summarizes the estimated changes in the fair value of our mortgage servicing rights for changes in those assumptions individually and in combination associated with an immediate 100 basis point increase or decrease in market rates. Also summarized is the earnings impact associated with provisions to or reductions in the valuation allowance for mortgage servicing rights. Impairment is measured on a disaggregated basis based upon the predominant risk

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characteristics of the underlying mortgage loans such as term and coupon. Certain stratum may have impairment, while other stratum may not. Therefore, changes in overall fair value may not equal provisions to or reductions in the valuation allowance.

The sensitivity analysis in the table below is hypothetical and should be used with caution. As the figures indicate, changes in fair value based on a 100 basis point variation in assumptions generally cannot be easily extrapolated because the relationship of the change in the assumptions to the change in fair value may not be linear. Also, in this table, the effect that a change in a particular assumption may have on the fair value is calculated without changing any other assumption. In reality, changes in one factor may result in changes in another, which might magnify or counteract the sensitivities.

(Dollars in Thousands)	Expected Prepayment Speeds	Value of Custodial Accounts	Discount Rate	Co
Increase rates 100 basis points:				
Fair value (1)	$ 20,675	$ 4,532	$ (1,741)	
Reduction of (increase in) valuation allowance ...	17,033	4,519	(1,741)	
Decrease rates 100 basis points:				
Fair value (2)	(17,562)	(4,532)	1,840	
Reduction of (increase in) valuation allowance ...	(17,562)	(4,532)	1,840	

The following table presents a breakdown of the components of our loan servicing income (loss) during the periods indicated.

	Three Months Ended			
(In Thousands)	June 30, 2002	March 31, 2002	December 31, 2001	September 30, 2001
Income from servicing operations	$ 3,349	$ 2,688	$ 2,477	$ 2,576
Amortization of MSRs	(3,253)	(2,916)	(2,956)	(2,495)
(Provision for) reduction of impairment ...	(15,713)	(360)	11,960	(11,852)
Total loan servicing income (loss), net	$(15,617)	$ (588)	$ 11,481	$(11,771)

(In Thousands)	Six Months Ended June 30, 2002	2001
Income from servicing operations	$ 6,037	$ 3,975
Amortization of MSRs	(6,169)	(4,362)
Provision for impairment	(16,073)	(10,696)
Total loan servicing loss, net	$(16,205)	$(11,083)

NOTE (5) - ACCOUNTING FOR DERIVATIVES AND HEDGING ACTIVITIES

DERIVATIVES

We offer short-term interest rate lock commitments to help us attract potential home loan borrowers. The commitments guarantee a specified interest rate for a loan if our underwriting standards are met, but do not obligate the potential borrower. Accordingly, a certain number of commitments never become loans and merely expire. The residential one-to-four unit rate lock commitments we ultimately expect to result in loans and sell in the secondary market are treated as derivatives. Consequently, as derivatives, the hedging of the expected rate lock commitments do not qualify for hedge accounting. Associated fair value adjustments to the notional amount of the expected rate lock commitments are recorded in current earnings under net gains on sales of loans and mortgage-backed securities with an offset to the balance sheet in either other assets, or accounts payable and accrued liabilities. Fair values for the notional amount of expected rate lock commitments are based on observable market prices acquired from third parties. The carrying amount of loans held for sale includes a basis adjustment to the loan balance at funding resulting from the change in the fair value of the rate lock derivative from the date of commitment to the date of funding. At June 30, 2002 we had a notional amount of expected rate

lock commitments identified to sell as part of our secondary marketing activities of $503 million, with an estimated fair value gain of $7.5 million, of which $5.1 million was associated with mortgage servicing rights.

HEDGING ACTIVITIES

As part of our secondary marketing activities, we typically utilize short-term forward sale and purchase contracts--derivatives--that mature in less than one year to offset the impact of changes in market interest rates on the value of our residential one-to-four unit expected rate lock commitments and loans held for sale. We do not generally enter into derivative transactions for purely speculative purposes. Contracts designated to loans held for sale are accounted for as cash flow hedges because these contracts have a high correlation to the price movement of the loans being hedged (within a range of 80% - 125%). The measurement approach for determining the ineffective aspects of the hedge is established at the inception of the hedge. Changes in fair value of the notional amount of forward sale contracts not designated to loans held for sale and the ineffectiveness of hedge transactions that are not perfectly correlated are recorded in net gains on sales of loans and mortgage-backed securities. Changes in fair value of the notional amount of forward sale contracts designated as cash flow hedges for loans held for sale are recorded in other comprehensive income, net of tax, provided cash flow hedge requirements

are met. The offset to these changes in fair value of the notional amount of forward sale contracts are recorded in the balance sheet as either other assets, or accounts payable and accrued liabilities. The amounts recorded in accumulated other comprehensive income will be recognized in the income statement when the hedged forecasted transactions settle. We estimate that all of the related unrealized gains or losses in accumulated other comprehensive income will be reclassified into earnings within the next three months. Fair values for the notional amount of forward sale contracts are based on observable market prices acquired from third parties. At June 30, 2002, the notional amount of forward sale contracts amounted to $880 million, with an estimated fair value loss of $5.1 million, of which $378 million were designated as cash flow hedges. The notional amount of forward purchase contracts amounted to $3.0 million, with a negligible estimated fair value gain that partially offsets the loss on our forward sale contracts not designated to loans held for sale.

We have not discontinued any designated derivative instruments associated with loans held for sale due to a change in the probability of settling a forecasted transaction.

The following table shows the impact from non-qualifying hedges and the ineffectiveness of cash flow hedges on net gains (losses) on sales of loans and mortgage-backed securities (i.e., SFAS 133 effect), as well as the impact to other comprehensive income (loss) from qualifying cash flow transactions. Also shown is the notional amount of expected rate lock commitment derivatives for loans originated for sale, loans held for sale and the notional amounts for their associated hedging derivatives (i.e., forward sale contracts).

	Three Mo		
(In Thousands)	June 30, 2002	March 31, 2002	Decem 2
Net gains (losses) on non-qualifying hedge transactions	$ (390)	$ 4,864	$ (
Net gains (losses) on qualifying cash flow hedge transactions:			
Unrealized hedge ineffectiveness	--	--	
Less reclassification of realized hedge ineffectiveness ...	--	--	
Total net gains (losses) recognized in sales of loans and mortgage-backed securities (SFAS 133 effect)	(390)	4,864	(
Other comprehensive income (loss)	(1,138)	1,355	
NOTIONAL AMOUNT AT PERIOD END			
Non-qualifying hedge transactions:			
Expected rate lock commitments	$ 503,359	$ 235,099	$ 26
Associated forward sale contracts	501,292	230,660	27
Associated forward purchase contracts	3	--	
Qualifying cash flow hedge transactions:			
Loans held for sale, at lower of cost or fair value	381,465	388,468	49
Associated forward sale contracts	378,238	392,099	50

Six Months Ended
June 30,

(In Thousands)	2002	2001
Net gains (losses) on non-qualifying hedge transactions	$ 4,474	$ (981)
Net losses on qualifying cash flow hedge transactions:		
Unrealized hedge ineffectiveness	--	(440)
Less reclassification of realized hedge ineffectiveness ...	--	440
Total net gains (losses) recognized in sales of loans and mortgage-backed securities (SFAS 133 effect)	4,474	(981)
Other comprehensive income	217	1,249

NOTE (6) - INCOME TAXES

Downey and its wholly owned subsidiaries file a consolidated federal income tax return and various state income and franchise tax returns on a calendar year basis. The Internal Revenue Service and state taxing authorities have examined Downey's tax returns for all tax years through 1997. Tax years subsequent to 1997 remain open to review. Downey's management believes it has adequately provided for potential exposure to issues that may be raised in the years open to review.

NOTE (7) - CURRENT ACCOUNTING ISSUES

Statement of Financial Accounting Standards No. 142. Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"), applies to all acquired intangible assets whether acquired singularly, as part of a group, or in a business combination. SFAS 142 supersedes APB Opinion No. 17, "Intangible Assets," and carries forward provisions in Opinion 17 related to internally developed intangible assets. SFAS 142 changes the accounting for goodwill from an amortization method to an impairment-only approach. Goodwill should no longer be amortized, but instead tested for impairment at least annually at the reporting unit level. The accounting provisions are effective for fiscal years beginning after December 31, 2001. Our intangible assets and goodwill are related to branch acquisitions and not within the scope of SFAS 142. We recognized an unidentified intangible asset for branch acquisitions because the fair value of the liabilities assumed exceeded the fair value of the assets acquired. However, under a current proposal being considered by the Financial Accounting Standards Board, assets of this nature that meet the definition of a business combination will be accounted for using the impairment-only approach. A final Statement regarding this proposal is expected to be issued in the fourth quarter of 2002. If adopted as proposed, we would stop amortizing the remaining excess of cost over fair value of branch acquisitions and record impairment, if necessary. For the second quarter of 2002, our amortization of excess cost over fair value of branch acquisitions was $0.1 million and as of June 30, 2002, this asset totaled $3 million. For the first six months of 2002, our amortization was $0.2 million.

Statement of Financial Accounting Standards No. 143. Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" ("SFAS 143"), addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS 143 is effective for financial statements issued for fiscal years beginning after June 15, 2002. It is anticipated that the financial impact of SFAS 143 will not have a material effect on Downey.

Statement of Financial Accounting Standards No. 144. Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"), addresses financial accounting and reporting for the impairment or disposal of long-lived assets. SFAS 144 supersedes SFAS

No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of," and the accounting and reporting provisions of APB Opinion No. 30, "Reporting the Results of Operations--Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," for the disposal of a business segment. SFAS 144 also eliminates the exception to consolidation for a subsidiary for which control is likely to be temporary. The provisions of SFAS 144 are effective for financial statements issued for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years. The provisions of SFAS 144 generally are to be applied prospectively. It is anticipated that the financial impact of SFAS 144 will not have a material effect on Downey.

Statement of Financial Accounting Standards No. 145. Statement of Financial Accounting Standards No. 145, "Rescission of SFAS Statements No. 4, 44, and 64, Amendment of SFAS Statement No. 13, and Technical Corrections" ("SFAS 145"), updates, clarifies and simplifies existing accounting pronouncements. SFAS 145 rescinds SFAS No. 4, "Reporting Gains and Losses from Extinguishment of Debt." SFAS 145 amends SFAS No. 13, "Accounting for Leases," to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for

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certain lease modifications that have economic effects that are similar to sale-leaseback transactions. The provisions of SFAS 145 related to SFAS No. 4 and SFAS No. 13 are effective for fiscal years beginning and transactions occurring after May 15, 2002, respectively. It is anticipated that the financial impact of SFAS 145 will not have a material effect on Downey.

Statement of Financial Accounting Standards No. 146. Statement of Financial Accounting Standards No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS 146"), requires Downey to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. SFAS 146 replaces Emerging Issues Task Force ("EITF") Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The provisions of SFAS 146 are to be applied prospectively to exit or disposal activities initiated after December 31, 2002.

NOTE (8) - SUBSEQUENT EVENTS

New Director. On July 8, 2002, Downey Financial Corp. announced that James H. Hunter had been elected a director of the boards of both Downey Financial Corp. and Downey Savings and Loan Association, F.A. (the "Bank"), increasing both Boards' membership to nine directors. James H. Hunter is Executive Vice President of Planning and Acquisition for The Corky McMillin Companies. As of June 30, 2002, the Bank had committed loans to The Corky McMillin Companies or affiliates totaling $72.0 million, of which $38.7 million had been disbursed. As of June 30, 2002, DSL Service Company, a wholly owned subsidiary of the Bank, had committed investments in joint ventures associated with The Corky McMillin Companies or affiliates totaling $19.8 million, of which $16.9 million had been disbursed. All such loans and investments are performing in accordance with their terms. The loan terms, including interest rates and collateral, are substantially the same as those prevailing at the time for comparable transactions with other non-related parties. In the opinion of management, those transactions neither involve more than the normal risk of collectibility or of return on investment, nor present any unfavorable features.

Stock Repurchase Program. On July 24, 2002, the Board of Directors of Downey Financial Corp. authorized a share repurchase program of up to $50 million of Downey's common stock. The shares will be repurchased from

time-to-time in open market transactions. The timing, volume and price of purchases will be made at the discretion of Downey, and will also be contingent upon Downey's overall financial condition, as well as market conditions in general.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Certain statements under this caption may constitute "forward-looking statements" under the Private Securities Litigation Reform Act of 1995 which involve risks and uncertainties. Our actual results may differ significantly from the results discussed in such forward-looking statements. Factors that might cause such a difference include, but are not limited to, economic conditions, competition in the geographic and business areas in which we conduct our operations, fluctuations in interest rates, credit quality and government regulation.

OVERVIEW

Our net income for the second quarter of 2002 totaled $20.3 million or $0.72 per share on a diluted basis, compared to $33.4 million or $1.18 per share in the second quarter of 2001.

The decline in our net income between second quarters was primarily due to a larger addition to the valuation allowance for mortgage servicing rights. The addition was reflected within the category of loan servicing loss and was necessary due to the decline in long-term interest rates, which resulted in an increase in the projected rate at which loans serviced for others are expected to prepay, thereby shortening their expected average life. In addition, the decline in long-term interest rates also reduced the expected value of associated custodial accounts. The pre-tax addition during the second quarter was $15.7 million, up from $2.4 million in the year-ago second quarter. Excluding the valuation allowances, our net income in the current quarter would have been $29.4 million, down $5.4 million or 15.6% from the adjusted year-ago level. This decline reflected a decrease of $6.2 million in adjusted net income from our banking operations, partially offset by a $0.7 million increase in net income from real estate investment activities. Adjusted net income from banking operations declined due to the following:

- a $6.0 million or 15.5% increase in operating expense due to higher costs associated with the increased number of branch locations and higher loan origination activity;
- a $5.0 million or 21.4% decline in other income primarily due to:
    - a $2.7 million decline in net gains from the sales of loans and mortgage servicing rights, as fewer loans were sold; and
    - a $2.6 million decline in loan and deposit related fees due primarily to lower loan prepayment fees.
- a $1.1 million or 1.5% decrease in net interest income due to a decline in both the effective interest rate spread and average earning assets.

These items were partially offset by a $1.1 million reversal of provision for loan losses during the quarter due to improved credit quality, compared to the year-ago quarter provision of $0.4 million.

For the first six months of 2002, our net income totaled $57.6 million or

$2.04 per share on a diluted basis, compared to $59.3 million or $2.09 per share for the first six months of 2001. The decline between six-month periods reflected lower net income from our banking operations and was primarily due to higher valuation provisions associated with mortgage servicing rights.

For the second quarter of 2002, our return on average assets was 0.75% and our return on average equity was 10.47%. For the first six months of 2002, our return on average assets was 1.06% and our return on average equity was 15.13%.

Our single family loan originations totaled $2.179 billion in the second quarter of 2002, up 2.7% from the $2.122 billion we originated in the second quarter of 2001 but 3.5% below the $2.259 billion we originated in the previous quarter. Of the current quarter total, $1.114 billion represented originations of loans for portfolio, of which $150 million represented subprime credits. In addition to single family loans, we originated $120 million of other loans in the quarter.

At quarter end, our assets totaled $11.1 billion, up 2.8% from a year ago, while our deposits totaled $8.7 billion, down 3.9% from a year ago. During the quarter, four new in-store branches were opened, bringing our total branches at quarter end to 148, of which 78 are in-store. A year ago, branches totaled 129, of which 63 were in-store.

Our non-performing assets declined $10 million during the quarter to $83 million or 0.75% of total assets. The decline was primarily in the residential one-to-four unit category.

At June 30, 2002, our primary subsidiary, Downey Savings and Loan Association, F.A. (the "Bank") exceeded all regulatory capital tests, with capital-to-asset ratios of 7.51% for both tangible and core capital and 15.16% for risk-based capital. These capital levels are significantly above the "well capitalized" standards defined by the federal banking regulators of 5% for core and tangible capital and 10% for risk-based capital.

CRITICAL ACCOUNTING POLICIES

We have established various accounting policies which govern the application of accounting principles generally accepted in the United States of America in the preparation of our financial statements. Our significant accounting policies are described in Downey's Annual Report on Form 10-K for the year ended December 31, 2001. Certain accounting policies require us to make significant estimates and assumptions which have a material impact on the carrying value of certain assets and liabilities, and we consider these to be critical accounting policies. The estimates and assumptions we use are based on historical experience and other factors, which we believe to be reasonable under the circumstances. Actual results could differ significantly from these estimates and assumptions which could have a material impact on the carrying value of assets and liabilities at the balance sheet dates and our results of operations for the reporting periods.

We believe the following are critical accounting policies that require the most significant estimates and assumptions that are particularly susceptible to significant change in the preparation of our financial statements:

- Allowance for losses on loans and real estate. For further information, see Financial Condition--Problem Loans and Real Estate--Allowance for Losses on Loans and Real Estate on page 35.
- Allowance for mortgage servicing rights. For further information, see Note 4 on page 8 of Notes to Consolidated Financial Statements.

RESULTS OF OPERATIONS

NET INTEREST INCOME

Net interest income is the difference between the interest and dividends earned on loans, mortgage-backed securities and investment securities ("interest-earning assets") and the interest paid on deposits, borrowings and capital securities ("interest-bearing liabilities"). The spread between the yield on interest-earning assets and the cost of interest-bearing liabilities and the relative dollar amounts of these assets and liabilities principally affects net interest income.

Our net interest income totaled $75.1 million in the second quarter of 2002, down $1.1 million or 1.5% from the same period last year. The decrease between second quarters reflected both a lower effective interest rate spread and lower interest-earning asset levels. The effective interest rate spread averaged 2.86% in the current quarter, below 2.89% of a year ago. The decrease between second quarters was due to our yield on interest-earning assets declining more rapidly than the decline in our cost of funds. This is indicative of what typically happens when interest rates decline, as there is an administrative lag in the repricing of our loans which are primarily priced to the Federal Home Loan Bank (the "FHLB") Eleventh District Cost of Funds Index ("COFI") and is reflective of the faster decline in COFI earlier in 2002. Our interest-earning assets averaged $10.5 billion during the quarter, slightly below the year-ago level.

For the first six months of 2002, net interest income totaled $155.1 million, up $2.7 million or 1.7% from a year ago. The increase reflected a higher effective interest rate spread as our earning asset levels remained relatively stable.

The following table presents for the periods indicated the total dollar amount of:

- interest income from average interest-earning assets and the resultant yields; and

- interest expense on average interest-bearing liabilities and the resultant costs, expressed as rates.

The table also sets forth our net interest income, interest rate spread and effective interest rate spread. The effective interest rate spread reflects the relative level of interest-earning assets to interest-bearing liabilities and equals:

- the difference between interest income on interest-earning assets and interest expense on interest-bearing liabilities, divided by

- average interest-earning assets for the period.

The table also sets forth our net interest-earning balance--the difference between the average balance of interest-earning assets and the average balance of total deposits, borrowings and capital securities--for the periods indicated. We included non-accrual loans in the average interest-earning assets balance. We included interest from non-accrual loans in interest income only to the extent we received payments and to the extent we believe we will recover the remaining principal balance of the loans. We computed average balances for the quarter using the average of each month's daily average balance during the periods indicated.

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	Three Months Ended			
	2002			
(Dollars in Thousands)	Average Balance	Interest	Average Yield/ Rate	A B
Interest-earning assets:				
Loans	$10,035,071	$ 148,448	5.92%	$10
Mortgage-backed securities	80,873	942	4.66	
Investment securities	385,738	4,035	4.20	
Total interest-earning assets	10,501,682	153,425	5.84	10
Non-interest-earning assets	391,884			
Total assets	$10,893,566			$10
Transaction accounts:				
Non-interest-bearing checking	$ 295,568	$ --	-- %	$
Interest-bearing checking (1)	425,609	329	0.31	
Money market	113,231	503	1.78	
Regular passbook	2,962,758	18,543	2.51	
Total transaction accounts	3,797,166	19,375	2.05	1
Certificates of deposit	4,763,479	41,022	3.45	7
Total deposits	8,560,645	60,397	2.83	8
Borrowings	1,299,644	14,859	4.59	1
Capital securities	120,000	3,041	10.14	
Total deposits, borrowings and capital securities	9,980,289	78,297	3.15	10
Other liabilities	137,644			
Stockholders' equity	775,633			
Total liabilities and stockholders' equity	$10,893,566			$10
Net interest income/interest rate spread		$ 75,128	2.69%	
Excess of interest-earning assets over deposits, borrowings and capital securities	$ 521,393			$
Effective interest rate spread			2.86	

	Six Months Ended Ju			
	2002			
(Dollars in Thousands)	Average Balance	Interest	Average Yield/ Rate	A B
Interest-earning assets:				
Loans	$10,004,439	$ 308,725	6.17%	$10
Mortgage-backed securities	93,624	2,216	4.73	
Investment securities	425,093	8,882	4.21	

Total interest-earning assets	10,523,156	319,823	6.08	10
Non-interest-earning assets	395,186			
Total assets	$10,918,342			$10
Transaction accounts:				
Non-interest-bearing checking	$ 290,362	$ --	-- %	$
Interest-bearing checking (1)	425,386	744	0.35	
Money market	111,973	1,010	1.82	
Regular passbook	2,702,876	33,936	2.53	
Total transaction accounts	3,530,597	35,690	2.04	1
Certificates of deposit	5,011,329	93,066	3.75	6
Total deposits	8,541,926	128,756	3.04	8
Borrowings	1,362,761	29,912	4.43	1
Capital securities	120,000	6,082	10.14	
Total deposits, borrowings and capital securities	10,024,687	164,750	3.31	10
Other liabilities	131,862			
Stockholders' equity	761,793			
Total liabilities and stockholders' equity	$10,918,342			$10
Net interest income/interest rate spread		$ 155,073	2.77%	
Excess of interest-earning assets over deposits, borrowings and capital securities	$ 498,469			$
Effective interest rate spread			2.95	

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Changes in our net interest income are a function of both changes in rates and changes in volumes of interest-earning assets and interest-bearing liabilities. The following table sets forth information regarding changes in our interest income and expense for the periods indicated. For each category of interest-earning assets and interest-bearing liabilities, we have provided information on changes attributable to:

- changes in volume--changes in volume multiplied by comparative period rate;

- changes in rate--changes in rate multiplied by comparative period volume; and

- changes in rate/volume--changes in rate multiplied by changes in volume.

Interest-earning asset and interest-bearing liability balances used in the calculations represent quarterly average balances computed using the average of each month's daily average balance during the period indicated.

	Three Months Ended June 30, 2002 Versus 2001 Changes Due To	Six M 2
	Rate/	

(In Thousands)	Volume	Rate	Volume	Net	Volume	
Interest income:						
Loans	$ (457)	$(55,038)	$ 123	$(55,372)	$ (4,728)	$
Mortgage-backed securities	1,158	(21)	(282)	855	2,786	
Investment securities	(1,687)	(2,086)	480	(3,293)	(1,267)	
Change in interest income	(986)	(57,145)	321	(57,810)	(3,209)	
Interest expense:						
Transaction accounts:						
Interest-bearing checking (1) .	20	(183)	(7)	(170)	64	
Money market	164	(231)	(59)	(126)	313	
Regular passbook	17,914	(2,035)	(4,851)	11,028	31,945	
Total transaction accounts ..	18,098	(2,449)	(4,917)	10,732	32,322	
Certificates of deposit	(34,822)	(44,579)	14,680	(64,721)	(60,210)	
Total interest-bearing deposits	(16,724)	(47,028)	9,763	(53,989)	(27,888)	
Borrowings	813	(3,368)	(148)	(2,703)	(3,440)	
Capital securities	--	--	--	--	--	
Change in interest expense	(15,911)	(50,396)	9,615	(56,692)	(31,328)	
Change in net interest income	$ 14,925	$ (6,749)	$(9,294)	$ (1,118)	$ 28,119	$

PROVISION FOR LOAN LOSSES

During the second quarter, $1.1 million of provision for loan losses was reversed due to an improvement in credit quality, while in the year-ago quarter the provision for loan losses totaled $0.4 million. The allowance for loan losses was $36 million at June 30, 2002, essentially unchanged from year-end 2001. Net charge-offs totaled $0.4 million in the second quarter of 2002, up slightly from $0.2 million a year ago.

For the first six months of 2002, provision for loan losses declined to $0.3 million from $0.5 million a year ago, and net charge-offs were unchanged at $0.6 million. The decline in provision for loan losses was primarily due to the current period improvement in credit quality. For further information regarding our allowance for loan losses, see Financial Condition--Problem Loans and Real Estate--Allowance for Losses on Loans and Real Estate on page 35.

OTHER INCOME

Our total other income was $4.1 million in the second quarter of 2002, down $18.2 million from a year ago reflecting:

- a $12.7 million increase in the loss on our loan servicing activity from the year-ago quarter primarily due to a larger addition to the valuation allowance for mortgage servicing rights, as their fair value dropped in the current quarter due to an approximate 60 basis point decline in long-term interest rates;

- a $2.7 million decrease in net gains on sales of loans and mortgage-backed securities and mortgage servicing rights as fewer loans were sold; and

- a $2.7 million decline in loan and deposit related fees, primarily due to a $3.3 million decline in loan prepayment fees.

Partially offsetting those declines was a $0.3 million increase in income from real estate held for investment.

For the first six months of 2002, total other income was $35.5 million, up $7.2 million from a year ago, primarily reflecting an $11.9 million increase in net gains on sales of loans and mortgage-backed securities, and a $2.3 million increase in income from real estate and joint ventures held for investment. Those favorable items were partially offset by a $5.1 million increase in the loss from loan servicing and a $1.5 million decrease in loan and deposit related fees. Below is a further discussion of the major other income categories.

LOAN AND DEPOSIT RELATED FEES

Loan and deposit related fees totaled $11.4 million in the second quarter of 2002, down $2.7 million from a year ago. Our loan related fees were down $3.5 million between second quarters, of which $3.3 million represented a decline in loan prepayment fees. This was partially offset by a $0.8 million or 18.8% increase in our deposit related fees, primarily due to higher fees from our checking accounts.

The following table presents a breakdown of loan and deposit related fees during the periods indicated.

	Three Months Ended			
(In Thousands)	June 30, 2002	March 31, 2002	December 31, 2001	September 30, 2001
Loan related fees:				
Prepayment fees	$ 4,140	$ 4,686	$ 5,475	$ 6,384
Other fees	1,992	2,167	2,477	2,257
Deposit related fees:				
Automated teller machine fees	1,668	1,543	1,670	1,671
Other fees	3,596	3,122	3,224	2,962
Total loan and deposit related fees	$11,396	$11,518	$12,846	$13,274

For the six months of 2002, loan and deposit related fees totaled $22.9 million, down $1.5 million from the same period of 2001. The decrease reflected a $3.2 million decline in loan prepayment fees, as deposit related fees were up $1.5 million.

The following table presents a breakdown of loan and deposit related fees during the periods indicated.

	Six Months Ended June 30,	
(In Thousands)	2002	2001

Loan related fees:		
Prepayment fees	$ 8,826	$11,980
Other fees	4,159	4,030
Deposit related fees:		
Automated teller machine fees	3,211	3,183
Other fees	6,718	5,173
Total loan and deposit related fees	$22,914	$24,366

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REAL ESTATE AND JOINT VENTURES HELD FOR INVESTMENT

Income from our real estate and joint ventures held for investment totaled $1.0 million in the second quarter of 2002, up $0.3 million from a year ago. The increase reflected increases of $0.9 million in net gains from sales and $0.2 million in interest from joint venture advances. The gains primarily relate to joint venture projects and are reported in the category of equity in net income from joint ventures. Those favorable items were partially offset by an increase of $0.8 million in the provision for losses on real estate and joint ventures due to a decline in the fair value of a shopping center.

The following table sets forth the key components comprising our income from real estate and joint venture operations during the periods indicated.

	Three Months End			
(In Thousands)	June 30, 2002	March 31, 2002	December 31, 2001	S
Rental operations, net of expenses	$ 521	$ 823	$ 1,026	
Equity in net income from joint ventures	1,001	745	212	
Interest from joint venture advances	304	111	83	
Net gains on sales of wholly owned real estate	8	--	127	
(Provision for) reduction of losses on real estate and joint ventures	(818)	1,318	(1)	
Total income from real estate and joint ventures held for investment, net	$ 1,016	$ 2,997	$ 1,447	

For the first six months of 2002, income from real estate and joint ventures held for investment totaled $4.0 million, up $2.3 million from the same period of 2001 due primarily to sales activity.

The following table sets forth the key components comprising our income from real estate and joint venture operations during the periods indicated.

	Six Months Ended June 30,	
(In Thousands)	2002	2001

Rental operations, net of expenses	$ 1,344	$ 960
Equity in net income from joint ventures	1,746	512
Interest from joint venture advances	415	284
Net gains on sales of wholly owned real estate	8	2
(Provision for) reduction of losses on real estate and joint ventures	500	(66)
Total income from real estate and joint ventures held for investment, net	$ 4,013	$ 1,692

SECONDARY MARKETING ACTIVITIES

Sales of loans and mortgage-backed securities decreased in the second quarter of 2002 to $1.093 billion from $1.364 billion a year ago. Net gains associated with these sales totaled $6.9 million in the current quarter, down $2.1 million from a year ago. Net gains in the current quarter included the capitalization of mortgage servicing rights totaling $10.2 million, compared to $13.4 million a year ago.

A loss of $15.6 million was recorded in loan servicing from our portfolio of loans serviced for others during the second quarter of 2002, a deterioration from a loss of $2.9 million in the year-ago period. This increased loss primarily reflected a larger addition to the valuation allowance for mortgage servicing rights, $15.7 million in the current quarter, compared to $2.4 million a year ago. The current quarter valuation addition was associated with the deterioration in fair value of mortgage servicing rights due to the approximate 60 basis point decline in long-term interest rates, which resulted in an increase in the projected rate at which loans serviced for others are expected to prepay, thereby shortening the expected average life. In addition, the decline in long-term interest rates also reduced the expected value of custodial accounts. At June 30, 2002, we serviced $7.0 billion of loans for others, compared to $5.8 billion at December 31, 2001 and $5.1 billion at June 30, 2001.

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The following table presents a breakdown of the components of our loan servicing income (loss) during the periods indicated.

	Three Months Ended			
(In Thousands)	June 30, 2002	March 31, 2002	December 31, 2001	September 3 2001
Income from servicing operations	$ 3,349	$ 2,688	$ 2,477	$ 2,576
Amortization of MSRs	(3,253)	(2,916)	(2,956)	(2,495)
(Provision for) reduction of impairment	(15,713)	(360)	11,960	(11,852)
Total loan servicing income (loss), net	$(15,617)	$ (588)	$ 11,481	$(11,771)

For the first six months of 2002, net gains on sales of loans and mortgage-backed securities totaled $23.1 million, up $11.9 million from the same period of 2001. For the first six months of 2002, a loss of $16.2 million was recorded in loan servicing, compared to a loss of $11.1 million from the same period of 2001 due to the larger addition to the valuation allowance for mortgage servicing rights.

The following table presents a breakdown of the components of our loan

servicing income (loss) during the periods indicated.

(In Thousands)	Six Months Ended June 30, 2002	2001
Income from servicing operations .	$ 6,037	$ 3,975
Amortization of MSRs	(6,169)	(4,362)
Provision for impairment	(16,073)	(10,696)
Total loan servicing loss, net	$(16,205)	$(11,083)

For further information regarding mortgage servicing rights, see Notes To Consolidated Financial Statements--Note (4)--Mortgage Servicing Rights on page 8.

OPERATING EXPENSE

Our operating expense totaled $45.1 million in the current quarter, up $5.0 million or 12.4% from the second quarter of 2001 because of higher general and administrative expense. That increase was primarily due to higher costs associated with an increased number of branch locations and higher loan origination activity.

The following table presents a breakdown of key components comprising operating expense during the periods indicated.

(In Thousands)	Three Months Ended June 30, 2002	March 31, 2002	December 31, 2001	September 3 2001
Salaries and related costs	$ 28,315	$ 29,437	$ 27,075	$ 24,943
Premises and equipment costs	7,754	7,133	7,303	6,628
Advertising expense	1,582	1,044	1,168	939
Professional fees	233	564	839	2,432
SAIF insurance premiums and regulatory assessments	762	786	792	786
Other general and administrative expense ...	6,350	6,211	6,339	5,981
Total general and administrative expense	44,996	45,175	43,516	41,709
Net operation of real estate acquired in settlement of loans	27	(58)	237	110
Amortization of excess cost over fair value of branch acquisitions	114	111	113	116
Total operating expense	$ 45,137	$ 45,228	$ 43,866	$ 41,935

For the first six months of 2002, operating expenses totaled $90.4 million,

up $13.0 million or 16.8% from the same period of 2001 and also reflected higher costs associated with the increased number of branch locations and higher loan origination activity.

The following table presents a breakdown of key components comprising operating expense during the periods indicated.

(In Thousands)	Six Months Ended June 30, 2002	2001
Salaries and related costs	$ 57,752	$ 47,917
Premises and equipment costs	14,887	12,085
Advertising expense	2,626	2,303
Professional fees	797	2,181
SAIF insurance premiums and regulatory assessments	1,548	1,473
Other general and administrative expense	12,561	11,312
Total general and administrative expense	90,171	77,271
Net operation of real estate acquired in settlement of loans	(31)	(108)
Amortization of excess cost over fair value of branch acquisitions	225	228
Total operating expense	$ 90,365	$ 77,391

PROVISION FOR INCOME TAXES

Income taxes for the second quarter totaled $14.9 million, compared to $24.5 million for the like quarter of a year ago. Our effective tax rate was unchanged at 42.3% for each of the current year and year-ago periods. For further information regarding income taxes, see Notes to Consolidated Financial Statements--Note (6)--Income Taxes on page 11.

BUSINESS SEGMENT REPORTING

The previous discussion and analysis of the Results of Operations pertained to our consolidated results. This section discusses and analyzes the results of operations of our two business segments--banking and real estate investment. For further information regarding business segments, see Notes To Consolidated Financial Statements--Note (3)--Business Segment Reporting on page 7.

The following table presents by business segment our net income for the periods indicated.

(In Thousands)	Three Months Ended June 30, 2002	March 31, 2002	December 31, 2001	September 30, 2001
Banking net income	$ 19,724	$ 35,557	$ 38,225	$ 22,301
Real estate investment net income (loss)	585	1,757	871	(535)
Total net income	$ 20,309	$ 37,314	$ 39,096	$ 21,766

	Six Months Ended June 30,	
	2002	2001
Banking net income	$55,281	$58,928
Real estate investment net income	2,342	391
Total net income	$57,623	$59,319

BANKING

Net income from our banking operations for the second quarter of 2002 totaled $19.7 million, down $13.9 million or 41.3% from $33.6 million in the second quarter of 2001. The decrease between second quarters primarily reflected a larger addition to the valuation allowance for mortgage servicing rights. The addition was reflected within the category of loan servicing loss and was necessary due to the approximate 60 basis point decline in long-term interest rates, which resulted in an increase in the projected rate at which loans serviced for others are expected to prepay, thereby shortening their expected

average life. In addition, the decline in long-term interest rates also reduced the expected value of associated custodial accounts. The pre-tax addition during the second quarter was $15.7 million, up from $2.4 million in the year-ago second quarter. Excluding the valuation allowances, our net income from our banking operations in the current quarter would have been $28.8 million, down $6.2 million or 17.6% from the adjusted year-ago level. Adjusted net income from banking operations decreased due to the following:

- a $6.0 million or 15.5% increase in operating expense due to higher costs associated with the increased number of branch locations and higher loan origination activity;
- a $5.0 million or 21.4% decrease in other income primarily due to:
    - a $2.7 million decrease in net gains from the sales of loans and mortgage servicing rights, as fewer loans were sold; and
    - a $2.6 million decrease in loan and deposit related fees due primarily to a $3.3 million decline in loan prepayment fees.
- a $1.1 million or 1.5% decrease in net interest income due to a decline in both the effective interest rate spread and average earning assets.

These items were partially offset by a $1.1 million reversal of provision for loan losses during the quarter due to improved credit quality and compares to the year-ago quarter provision of $0.4 million.

The following table sets forth our banking operational results and selected financial data for the periods indicated.

Three Months Ended

(In Thousands)	June 30, 2002	March 31, 2002	December 31, 2001	Septem 20
Net interest income	$ 75,115	$ 79,940	$ 79,730	$ 73
Provision for (reduction of) loan losses	(1,106)	1,447	1,290	
Other income	2,803	28,062	31,397	5
Operating expense	44,893	45,006	43,680	40
Net intercompany income	86	93	96	
Income before income taxes	34,217	61,642	66,253	38
Income taxes	14,493	26,085	28,028	16
Net income	$ 19,724	$ 35,557	$ 38,225	$ 22
AT PERIOD END				
Assets:				
Loans and mortgage-backed securities	$ 10,286,033	$ 10,088,113	$ 10,132,413	$ 9,912
Other	840,416	819,407	966,942	797
Total assets	11,126,449	10,907,520	11,099,355	10,710
Equity	$ 787,306	$ 767,622	$ 733,896	$ 698

For the first six months of 2002, our net income from banking totaled $55.3 million, down $3.6 million from the same period a year ago due primarily to the larger addition to the valuation allowance for mortgage servicing rights.

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The following table sets forth our banking operational results for the periods indicated.

(In Thousands)	Six Months Ended June 30, 2002	2001
Net interest income	$155,055	$152,370
Provision for loan losses	341	483
Other income	30,865	25,956
Operating expense	89,899	75,853
Net intercompany income ..	179	181
Income before income taxes	95,859	102,171
Income taxes	40,578	43,243
Net income	$ 55,281	$ 58,928

REAL ESTATE INVESTMENT

Net income from our real estate investment operations totaled $0.6 million in the second quarter of 2002, compared to a net loss of $0.2 million in the year-ago quarter. The increase was primarily attributed to lower operating expenses, as the year-ago quarter included expense pertaining to litigation matters associated with certain joint venture partners.

The following table sets forth real estate investment operational results and selected financial data for the periods indicated.

(In Thousands)	Three Months Ended June 30, 2002	March 31, 2002	December 31, 2001	Septembe 2001
Net interest income (expense)	$ 13	$ 5	$ (15)	$ (2
Other income	1,299	3,291	1,773	1,08
Operating expense	244	222	186	1,86
Net intercompany expense	86	93	96	9
Income (loss) before income taxes (benefit) ...	982	2,981	1,476	(89
Income taxes (benefit)	397	1,224	605	(36
Net income (loss)	$ 585	$ 1,757	$ 871	$ (53
AT PERIOD END				
Assets:				
Investment in real estate and joint ventures	$ 40,283	$ 26,384	$ 38,185	$ 38,04
Other	1,919	4,060	2,003	1,62
Total assets	42,202	30,444	40,188	39,67
Equity	$ 38,448	$ 24,963	$ 34,513	$ 33,64

For the first six months of 2002, our net income from real estate investment operations totaled $2.3 million, up from $0.4 million from the same period a year ago due primarily to sales activity and lower operating expenses, for the same reasons previously explained for the quarter.

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The following table sets forth our real estate investment operational results for the periods indicated.

(In Thousands)	Six Months Ended June 30, 2002	2001
Net interest income	$ 18	$ 38
Other income	4,590	2,340
Operating expense	466	1,538
Net intercompany expense .	179	181
Income before income taxes	3,963	659
Income taxes	1,621	268
Net income	$2,342	$ 391

Our investment in real estate and joint ventures amounted to $40 million at June 30, 2002, compared to $38 million at December 31, 2001 and $20 million at June 30, 2001. During the quarter, the Bank invested an additional $13 million into our real estate investment business for a new joint venture project. That additional investment is deducted from equity in determining the Bank's regulatory capital.

For information on valuation allowances associated with real estate and joint venture loans, see Financial Condition--Problem Loans and Real Estate--Allowances for Losses on Loans and Real Estate on page 35.

FINANCIAL CONDITION

LOANS AND MORTGAGE-BACKED SECURITIES

Total loans and mortgage-backed securities, including those we hold for sale, increased $198 million during the second quarter to a total of $10.3 billion or 92.4% of assets at June 30, 2002. The increase primarily represented a higher level of loans held for investment in the residential one-to-four unit adjustable category. Given the continued low interest rate environment and borrower preference for fixed rate loans, our annualized prepayment speed in the current quarter remained high at 38%, compared to 44% a year ago and 39% during the previous quarter.

The following table sets forth loans originated, including purchases, for investment and for sale during the periods indicated.

(In Thousands)	Three Months Ended June 30, 2002	March 31, 2002	June 30, 2001	
Loans originated for investment:				
Residential one-to-four units:				
Adjustable	$1,109,982	$ 988,063	$ 814,696	$2,
Fixed	3,940	4,366	10,849	
Other	119,970	45,752	43,492	
Total loans originated for investment	1,233,892	1,038,181	869,037	2,
Loans originated for sale (1)	1,065,360	1,266,430	1,296,877	2,
Total loans originated	$2,299,252	$2,304,611	$2,165,914	$4,

Originations of residential one-to-four unit loans totaled $2.179 billion in the second quarter of 2002, of which $1.114 billion or 51% were for portfolio, with the balance for sale in the secondary market. This was 3.5% lower than the $2.259 billion we originated in the first quarter of 2002 but 2.7% higher than the $2.122 billion we originated in the year-ago second quarter. Of the current quarter originations for portfolio, $150 million represented originations of subprime credits as part of our continuing strategy to enhance the portfolio's net yield. During the current quarter, 67% of our residential one-to-four unit originations represented refinancing transactions. This is down from the previous quarter level of 80% and slightly lower than the

72% in the year-ago second quarter. In addition to single family loans, we originated $120 million of other loans in the current quarter.

During the current quarter, loan originations for investment consisted primarily of adjustable rate mortgages tied to COFI, an index which lags behind the movement in market interest rates. This experience is similar to that of recent quarters.

Our adjustable rate mortgages:

- generally begin with an incentive interest rate, which is an interest rate below the current market rate, that adjusts to the applicable index plus a defined spread, subject to periodic and lifetime caps, after one, three, six or twelve months;
- generally provide that the maximum interest rate we can charge borrowers cannot exceed the incentive rate by more than six to nine percentage points, depending on the type of loan and the initial rate offered; and
- limit interest rate adjustments, for loans that adjust both the interest rate and payment amount simultaneously, to 1% per adjustment period for those that adjust semi-annually and 2% per adjustment period for those that adjust annually.

Most of our adjustable rate mortgages adjust the interest rate monthly and the payment amount annually. These monthly adjustable rate mortgages:

- have a lifetime interest rate cap, but no specified periodic interest rate adjustment cap;
- have a periodic cap on changes in required monthly payments; and

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- allow for negative amortization, which is the addition to loan principal of accrued interest that exceeds the required monthly loan payments.

If a loan incurs significant negative amortization, the loan-to-value ratio could increase which indicates an increased risk that the fair value of the underlying collateral on the loan would be insufficient to satisfy fully the outstanding principal and interest. A loan-to-value ratio is the ratio of the principal amount of the loan to the lower of the sales price or appraised value of the property securing the loan at origination. We currently impose a limit on the amount of negative amortization. The principal plus the added amount cannot exceed 125% of the original loan amount, except for subprime loans and loans with loan-to-value ratios of 80% or greater wherein the borrower has obtained private mortgage insurance to reduce the effective loan-to-value ratio to between 70% and 78%. In those two instances, the principal plus negative amortization cannot exceed 110% of the original loan amount.

At June 30, 2002, $7.1 billion or 77% of the adjustable rate mortgages in our loan portfolio were subject to negative amortization, of which $146 million represented the amount of negative amortization included in the loan balance.

We also continue to originate residential fixed interest rate mortgage loans to meet consumer demand, but we intend to sell the majority of these loans. We sold through our secondary marketing activities $1.093 billion of loans and mortgage-backed securities in the second quarter of 2002, compared to $1.381 billion in the previous quarter and $1.364 billion in the second quarter of 2001. All were secured by residential one-to-four unit property, and at June

30, 2002, loans held for sale totaled $381 million.

At June 30, 2002, our unfunded loan application pipeline totaled $1.8 billion. Within that pipeline, we had commitments to borrowers for short-term interest rate locks of $913 million, of which $636 million were related to residential one-to-four unit loans being originated for sale in the secondary market. Furthermore, we had commitments on loans in process of $101 million and undrawn lines of credit of $88 million. We believe our current sources of funds will enable us to meet these obligations.

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The following table sets forth the origination, purchase and sale activity relating to our loans and mortgage-backed securities during the periods indicated.

(In Thousands)	Three M		
	June 30, 2002	March 31, 2002	Dec
INVESTMENT PORTFOLIO			
Loans originated:			
Loans secured by real estate:			
Residential one-to-four units:			
Adjustable	$ 868,022	$ 515,686	$
Adjustable - subprime	148,876	107,334	
Adjustable - fixed for 3-5 years	85,679	365,043	
Adjustable - fixed for 3-5 years - subprime	133	--	
Total adjustable residential one-to-four units	1,102,710	988,063	
Fixed	3,940	4,336	
Fixed - subprime	--	--	
Residential five or more units:			
Adjustable	--	--	
Fixed	--	--	
Total residential	1,106,650	992,399	
Commercial real estate	--	--	
Construction	65,030	13,672	
Land	37,820	18,542	
Non-mortgage:			
Commercial	600	1,361	
Automobile	329	376	
Other consumer	16,191	11,801	
Total loans originated	1,226,620	1,038,151	
Real estate loans purchased:			
One-to-four units	6,459	30	
One-to-four units - subprime	813	--	
Other (1)	--	--	
Total real estate loans purchased	7,272	30	
Total loans originated and purchased	1,233,892	1,038,181	
Loan repayments	(950,438)	(942,811)	(
Other net changes (2)	(45,850)	(936)	
Net increase (decrease) in loans held for investment	237,604	94,434	

SALE PORTFOLIO			
Residential one-to-four units:			
Originated whole loans	1,060,399	1,264,559	1,
Loans purchased	4,961	1,871	
Loans transferred to the investment portfolio	(1,401)	(614)	
Originated whole loans sold	(132,614)	(156,206)	(
Loans exchanged for mortgage-backed securities	(943,883)	(1,225,243)	(1,
Other net changes	(594)	(789)	
Capitalized basis adjustment (3)	6,129	5,866	
Net increase (decrease) in loans held for sale	(7,003)	(110,556)	
Mortgage-backed securities, net:			
Received in exchange for loans	943,883	1,225,243	1,
Sold	(960,840)	(1,225,243)	(1,
Purchased	--	--	
Repayments	(18,950)	(26,553)	
Other net changes	3,226	(1,625)	
Net increase (decrease) in mortgage-backed securities available for sale	(32,681)	(28,178)	
Net increase (decrease) in loans held for sale and mortgage-backed securities available for sale	(39,684)	(138,734)	
Total net increase (decrease) in loans and mortgage-backed securities	$ 197,920	$ (44,300)	$

The following table sets forth the composition of our loan and mortgage-backed securities portfolio at the dates indicated.

(In Thousands)	June 30, 2002	March 31, 2002	December 2001
INVESTMENT PORTFOLIO			
Loans secured by real estate:			
Residential one-to-four units:			
Adjustable	$ 6,590,943	$ 6,279,350	$ 6,365,
Adjustable - subprime	1,357,098	1,365,817	1,424,
Adjustable - fixed for 3-5 years	1,271,031	1,294,855	999,
Adjustable - fixed for 3-5 years - subprime	48,835	57,844	66,
Fixed	260,934	295,228	334,
Fixed - subprime	11,982	13,099	15,
Total residential one-to-four units	9,540,823	9,306,193	9,205,
Residential five or more units:			
Adjustable	4,952	5,920	6,
Fixed	3,775	4,230	5,
Commercial real estate:			
Adjustable	40,200	40,650	40,
Fixed	41,522	69,691	71,
Construction	124,318	78,202	84,
Land	62,182	36,303	22,

Non-mortgage:			
Commercial	17,371	21,182	22,
Automobile	17,667	20,902	24,
Other consumer	50,101	48,067	50,
Total loans held for investment	9,902,911	9,631,340	9,533,
Increase (decrease) for:			
Undisbursed loan funds	(106,557)	(65,813)	(61,
Net deferred costs and premiums	85,926	80,622	77,
Allowance for losses	(35,834)	(37,307)	(36,
Total loans held for investment, net	9,846,446	9,608,842	9,514,
SALE PORTFOLIO, NET			
Loans held for sale:			
Residential one-to-four units	379,796	392,928	509,
Capitalized basis adjustment (1)	1,669	(4,460)	(10,
Total loans held for sale	381,465	388,468	499,
Mortgage-backed securities available for sale:			
Adjustable	58,122	73,792	101,
Fixed	--	17,011	17,
Total mortgage-backed securities available for sale	58,122	90,803	118,
Total loans held for sale and mortgage-backed securities available for sale	439,587	479,271	618,
Total loans and mortgage-backed securities	$ 10,286,033	$ 10,088,113	$ 10,132,

We carry loans for sale at the lower of cost or fair value. At June 30, 2002, no valuation allowance was required as the fair value exceeded book value on an aggregate basis.

At June 30, 2002, our residential one-to-four units subprime portfolio consisted of approximately 83% "A-" credit, 15% "B" credit and 2% "C" credit loans. At June 30, 2002, the average loan-to-value ratio at origination for these loans was approximately 75%.

We carry mortgage-backed securities available for sale at fair value which, at June 30, 2002, reflected an unrealized gain of $0.3 million. The current quarter-end unrealized loss, less the associated tax effect, is reflected within a separate component of other comprehensive income (loss) until realized.

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DEPOSITS

At June 30, 2002, our deposits totaled $8.7 billion, down $350 million from the year-ago level, but up $92 million during the quarter, which more than offset the first quarter 2002 decline. Compared to the year-ago period, our certificates of deposit declined $2.5 billion or 33.9%, which was partially offset by an increase in our lower-rate transaction accounts--i.e., checking, money market and regular passbook--of $2.1 billion, more than double the year-ago level. Within transaction accounts, the increase primarily occurred in our regular passbook accounts, as depositors moved monies from certificates of deposit because they seemed more interested in liquidity given the relatively low level of interest rates. At June 30, 2002, the average deposit size of our traditional branches was $105 million, while the average size of our in-store

branches was $17 million, or $20 million excluding the 15 new in-store branches opened within the past 12 months.

The following table sets forth information concerning our deposits and weighted average rates paid at the dates indicated.

(Dollars in Thousands)	June 30, 2002		March 31, 2002		December 31, 2001		September
	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate
Transaction accounts:							
Non-interest-bearing checking	-- %	$ 295,788	-- %	$ 312,962	-- %	$ 263,165	-- % $
Interest-bearing checking (1)	0.25	418,310	0.25	436,612	0.35	423,776	0.42
Money market	1.80	114,618	1.82	112,646	2.01	108,747	2.29
Regular passbook	2.42	3,082,356	2.57	2,789,500	2.46	2,131,048	2.96
Total transaction accounts	1.99	3,911,072	2.05	3,651,720	1.92	2,926,736	2.00
Certificates of deposit:							
Less than 3.00%	2.50	1,764,986	2.45	1,467,532	2.41	970,854	2.41
3.00-3.49	3.33	1,258,969	3.29	1,080,673	3.20	458,511	3.26
3.50-3.99	3.84	588,142	3.84	527,613	3.84	532,634	3.83
4.00-4.49	4.25	563,298	4.23	830,142	4.22	892,517	4.22
4.50-4.99	4.80	456,618	4.76	495,530	4.76	555,885	4.73
5.00-5.99	5.43	74,154	5.21	356,605	5.30	921,510	5.36
6.00 and greater	6.26	73,319	6.32	189,075	6.37	1,360,919	6.46
Total certificates of deposit	3.41	4,779,486	3.66	4,947,170	4.54	5,692,830	5.24
Total deposits	2.77%	$8,690,558	2.98%	$8,598,890	3.65%	$8,619,566	4.46% $

BORROWINGS

During the current quarter, our borrowings increased $93 million to $1.4 billion, due to an increase in FHLB advances. This followed a decrease of $202 million during the first quarter of 2002.

The following table sets forth information concerning our FHLB advances and other borrowings at the dates indicated.

(Dollars in Thousands)	June 30, 2002	March 31, 2002	December 31, 2001
Federal Home Loan Bank advances	$ 1,413,607	$ 1,320,386	$1,522,705
Other borrowings	--	--	7
Total borrowings	$ 1,413,607	$ 1,320,386	$1,522,712

Weighted average rate on borrowings during the period	4.59%	4.28%	4.31%
Total borrowings as a percentage of total assets	12.70	12.10	13.71

CAPITAL SECURITIES

On July 23, 1999, we issued $120 million in capital securities through Downey Financial Capital Trust I. The capital securities pay quarterly cumulative cash distributions at an annual rate of 10.00% of the liquidation value of $25 per share. Interest expense on our capital securities, including the amortization of deferred issuance costs, was $3.0 million for the second quarter of 2002 and $6.1 million for the first six months of 2002.

ASSET/LIABILITY MANAGEMENT AND MARKET RISK

Market risk is the risk of loss from adverse changes in market prices and interest rates. Our market risk arises primarily from interest rate risk in our lending and deposit taking activities. This interest rate risk primarily occurs to the degree that our interest-bearing liabilities reprice or mature on a different basis--generally more rapidly--than our interest-earning assets. Since our earnings depend primarily on our net interest income, which is the difference between the interest and dividends earned on interest-earning assets and the interest paid on interest-bearing liabilities, one of our principal objectives is to actively monitor and manage the effects of adverse changes in interest rates on net interest income while maintaining asset quality. Our primary strategy to manage interest rate risk is to emphasize the origination of adjustable rate mortgages or loans with relatively short maturities. Interest rates on adjustable rate mortgages are primarily tied to COFI.

In addition to the market risk associated with our lending and deposit taking activities, we also have market risk associated with our secondary marketing activities. Changes in mortgage interest rates, primarily fixed rate mortgages, impact the fair value of loans held for sale as well as our off-balance sheet commitments where we have committed to an interest rate with a potential borrower for a loan we intend to sell (known as an interest rate lock commitment derivative). Our objective is to hedge against fluctuations in interest rates through use of forward sale and purchase contracts with government-sponsored enterprises and whole loan sale contracts with various parties. These contracts are typically obtained at the time the interest rate lock commitments are made. Therefore, as interest rates fluctuate, the changes in the fair value of our interest rate lock commitments and loans held for sale tend to be offset by changes in the fair value of the hedge contracts. Although we continue to hedge as previously done, SFAS 133, as applied to our risk management strategies, may increase or decrease reported net income and stockholders' equity, depending on levels of interest rates and other variables affecting the fair values of derivative instruments and hedged items, but will have no effect on the overall economics of the transactions. We currently do not enter into hedging contracts for speculative purposes.

Changes in mortgage interest rates also impact the value of our mortgage servicing rights. Rising interest rates typically result in slower prepayment speeds on the loans being serviced for others which increase the value of mortgage servicing rights. Declining interest rates typically result in faster prepayment speeds which decrease the value of mortgage servicing rights. Currently, we do not hedge our mortgage servicing rights against that risk.

There has been no significant change in our market risk since December 31, 2001.

One measure of our exposure to differential changes in interest rates between assets and liabilities is shown in the following table which sets forth the repricing frequency of our major asset and liability categories as of June 30, 2002, as well as other information regarding the repricing and maturity differences between our interest-earning assets and total deposits, borrowings and capital securities in future periods. We refer to these differences as "gap." We have determined the repricing frequencies by reference to projected maturities, based upon contractual maturities as adjusted for scheduled repayments and "repricing mechanisms"--provisions for changes in the interest and dividend rates of assets and liabilities. We assume prepayment rates on substantially all of our loan portfolio based upon our historical loan prepayment experience and anticipated future prepayments. Repricing mechanisms on a number of our assets are subject to limitations, such as caps on the amount that interest rates and payments on our loans may adjust, and accordingly, these assets do not normally respond to changes in market interest rates as completely or rapidly as our liabilities. The interest rate sensitivity of our assets and liabilities illustrated in the following table would vary substantially if we used different assumptions or if actual experience differed from the assumptions set forth.

	June 30, 2		
(Dollars in Thousands)	Within 6 Months	7 - 12 Months	1 - 5 Years
Interest-earning assets:			
Investment securities and FHLB stock ....(1)	$ 234,618	$ 40,116	$ 155,270 $
Loans and mortgage-backed securities: ....(2)			
Loans secured by real estate:			
Residential:			
Adjustable	8,046,379	144,880	1,163,580
Fixed	432,932	52,741	133,102
Commercial real estate	36,120	7,124	16,822
Construction	52,046	--	--
Land	29,742	9	66
Non-mortgage loans:			
Commercial	10,740	--	--
Consumer	53,527	3,856	9,114
Mortgage-backed securities	31,131	26,991	--
Total loans and mortgage-backed securities	8,692,617	235,601	1,322,684
Total interest-earning assets	$8,927,235	$ 275,717	$ 1,477,954 $
Transaction accounts:			
Non-interest-bearing checking	$ 295,788	$ --	$ -- $
Interest-bearing checking ....(3)	418,310	--	--
Money market ....(4)	114,618	--	--
Regular passbook ....(4)	3,082,356	--	--
Total transaction accounts	3,911,072	--	--
Certificates of deposit ....(1)	2,300,250	1,240,945	1,238,291
Total deposits	6,211,322	1,240,945	1,238,291
Borrowings	273,123	60,134	621,350
Capital securities	--	--	--

Total deposits, borrowings and capital securities	$6,484,445	$ 1,301,079	$ 1,859,641	$
Excess (shortfall) of interest-earning assets over deposits, borrowings and capital securities ...	$2,442,790	$(1,025,362)	$ (381,687)	$
Cumulative gap	2,442,790	1,417,428	1,035,741	
Cumulative gap - as a percent of total assets:				
June 30, 2002	21.95%	12.73%	9.31%	
December 31, 2001	12.01	4.76	7.91	
June 30, 2001	18.03	3.28	6.87	

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Our six-month gap at June 30, 2002 was a positive 21.95%. This means that more interest-earning assets reprice within six months than total deposits, borrowings and capital securities. This compares to a positive six-month gap of 12.01% at December 31, 2001 and 18.03% at June 30, 2001.

We continue to pursue our strategy of emphasizing the origination of adjustable rate mortgages. For the twelve months ended June 30, 2002, we originated and purchased for investment $4.1 billion of adjustable rate loans which represented approximately 99% of all loans we originated and purchased for investment during the period.

At June 30, 2002, essentially all of our interest-earning assets mature, reprice or are estimated to prepay within five years, compared to 99% at December 31, 2001 and 98% at June 30, 2001. At June 30, 2002, loans held for investment and mortgage-backed securities with adjustable interest rates represented 93% of those portfolios. During the second quarter of 2002, we continued to offer residential fixed rate loan products to our customers primarily for sale in the secondary market. We price and originate fixed rate mortgage loans for sale into the secondary market to increase opportunities to originate adjustable rate mortgages and to generate fees and servicing income. We also originate fixed rate loans for portfolio to facilitate the sale of real estate acquired in settlement of loans and which meet specific yield and other approved guidelines.

At June 30, 2002, $9.7 billion or 94% of our total loan portfolio, including mortgage-backed securities, consisted of adjustable rate loans, construction loans, and loans with a due date of five years or less, compared to $9.3 billion or 91% at December 31, 2001, and $9.2 billion or 92% at June 30, 2001.

The following table sets forth the interest rate spread between our interest-earning assets and interest-bearing liabilities at the dates indicated.

	June 30, 2002	March 31, 2002	December 31, 2001	September 30, 2001	J
Weighted average yield:					
Loans and mortgage-backed securities	6.01%	6.45%	7.15%	7.68%	
Federal Home Loan Bank stock	5.56	5.30	5.31	6.00	
Investment securities	3.44	3.43	3.54	5.18	
Interest-earning assets yield	5.93	6.35	6.98	7.59	

Weighted average cost:				
Deposits	2.77	2.98	3.65	4.46
Borrowings:				
Federal Home Loan Bank advances ..	4.32	4.63	3.73	4.70
Other borrowings	--	--	7.88	7.88
Total borrowings	4.32	4.63	3.73	4.70
Capital securities	10.00	10.00	10.00	10.00
Combined funds cost	3.07	3.28	3.74	4.55
Interest rate spread	2.86%	3.07%	3.24%	3.04%

The period-end weighted average yield on our loan portfolio declined to 6.01% at June 30, 2002, down from 7.15% at December 31, 2001 and 8.24% at June 30, 2001. At June 30, 2002, our adjustable rate mortgage portfolio of single family residential loans, including mortgage-backed securitites, totaled $9.4 billion with a weighted average rate of 5.91%, compared to $9.0 billion with a weighted average rate of 7.11% at December 31, 2001, and $8.8 billlion with a weighted average rate of 8.27% at June 30, 2001.

PROBLEM LOANS AND REAL ESTATE

NON-PERFORMING ASSETS

Non-performing assets consist of loans on which we have ceased the accrual of interest (which we refer to as non-accrual loans), loans restructured at a below market rate, real estate acquired in settlement of loans and repossessed automobiles. Non-performing assets decreased $10 million during the quarter to $83 million or 0.75% of total assets. This decrease was primarily due to a decline in residential non-performers, of which $2 million related to residential subprime non-performers. Non-performing assets at quarter end included non-accrual loans aggregating $4 million which were not contractually past due, but were deemed non-accrual due to management's assessment of the borrower's ability to pay.

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The following table summarizes our non-performing assets at the dates indicated.

(Dollars in Thousands)	June 30, 2002	March 31, 2002	December 31, 2001	Sept
Non-accrual loans:				
Residential one-to-four units	$33,827	$43,934	$43,210	$2
Residential one-to-four units - subprime	31,540	33,169	31,166	3
Other	4,305	4,589	2,668	
Total non-accrual loans	69,672	81,692	77,044	6
Troubled debt restructure - below market rate (1) ...	203	203	203	
Real estate acquired in settlement of loans	13,528	11,917	15,366	1
Repossessed automobiles	16	19	19	
Total non-performing assets	$83,419	$93,831	$92,632	$7
Allowance for loan losses:				

Amount	$35,834	$37,307	$36,120	$3
As a percentage of non-performing loans	51.28%	45.55%	46.76%	
Non-performing assets as a percentage of total assets	0.75	0.86	0.83	

DELINQUENT LOANS

Loans delinquent 30 days or more declined during the quarter to 0.91% at June 30, 2002, from 1.05% at March 31, 2002, but were above the 0.81% of a year ago. The decline during the current quarter primarily occurred in both our residential one-to-four units and residential one-to-four units - subprime categories.

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The following table indicates the amounts of our past due loans at the dates indicated.

(Dollars in Thousands)	June 30, 2002 30-59 Days	60-89 Days	90+ Days (1)	Total	30-59 Days	
Loans secured by real estate:						
Residential:						
One-to-four units	$ 20,531	$ 6,461	$ 27,472	$ 54,464	$ 19,454	$
One-to-four units - subprime	10,694	3,308	24,228	38,230	13,653	
Five or more units	--	--	--	--	--	
Commercial real estate	--	--	--	--	--	
Construction	--	--	--	--	--	
Land	--	--	--	--	--	
Total real estate loans	31,225	9,769	51,700	92,694	33,107	
Non-mortgage:						
Commercial	--	--	428	428	--	
Automobile	190	13	54	257	138	
Other consumer	314	132	180	626	142	
Total delinquent loans	$ 31,729	$ 9,914	$ 52,362	$ 94,005	$ 33,387	$
Delinquencies as a percentage of total loans	0.31%	0.10%	0.51%	0.91%	0.33%	

	December 31, 2001					
Loans secured by real estate:						
Residential:						
One-to-four units	$ 19,170	$ 12,797	$ 33,449	$ 65,416	$ 18,515	$
One-to-four units - subprime	13,159	9,104	20,958	43,221	11,212	
Five or more units	--	--	--	--	--	
Commercial real estate	--	--	--	--	--	
Construction	--	--	--	--	--	
Land	--	--	--	--	--	
Total real estate loans	32,329	21,901	54,407	108,637	29,727	
Non-mortgage:						

Commercial	--	--	1,163	1,163	--	
Automobile	174	85	46	305	269	
Other consumer	356	62	173	591	253	
Total delinquent loans	$ 32,859	$ 22,048	$ 55,789	$110,696	$ 30,249	$
Delinquencies as a percentage of total loans	0.33%	0.22%	0.55%	1.10%	0.30%	

	June 30, 2001			
Loans secured by real estate:				
Residential:				
One-to-four units	$ 15,190	$ 7,262	$ 17,291	$ 39,743
One-to-four units - subprime	11,402	6,513	20,772	38,687
Five or more units	--	--	248	248
Commercial real estate	--	--	--	--
Construction	--	--	--	--
Land	--	--	--	--
Total real estate loans	26,592	13,775	38,311	78,678
Non-mortgage:				
Commercial	--	--	1,290	1,290
Automobile	112	63	32	207
Other consumer	287	28	185	500
Total delinquent loans	$ 26,991	$ 13,866	$ 39,818	$ 80,675
Delinquencies as a percentage of total loans	0.27%	0.14%	0.40%	0.81%

ALLOWANCE FOR LOSSES ON LOANS AND REAL ESTATE

We maintain a valuation allowance for losses on loans and real estate to provide for losses inherent in those portfolios. The adequacy of the allowance is evaluated quarterly by management to maintain the allowance at levels sufficient to provide for inherent losses.

We adhere to an internal asset review system and loss allowance methodology designed to provide for timely recognition of problem assets and an adequate valuation allowance to cover asset losses. The amount of the allowance is based upon the summation of general valuation allowances, allocated allowances and an unallocated allowance. General valuation allowances relate to assets with no well-defined deficiency or weakness and takes into consideration loss that is imbedded within the portfolio but has not yet been realized. Allocated allowances relate to assets with well-defined deficiencies or weaknesses. Included in both these allowances are those amounts associated with assets where it is probable that the recorded value of the asset has declined and the loss can be reasonably estimated. If we determine the carrying value of our asset exceeds its net fair value and no alternative payment source exists, then a specific allowance is recorded for the amount of that difference. The unallocated allowance is more subjective and is reviewed quarterly to take into consideration estimation errors and economic trends that are not necessarily captured in determining the general valuation and allocated allowances.

Allowances for losses on all assets were $38 million at June 30, 2002, compared to $39 million at December 31, 2001, and $37 million at June 30, 2001.

During the current quarter, we reversed $1.1 million of provision for loan losses due to an improvement in asset quality and net loan charge-offs totaled $0.4 million resulting in a decrease in the allowance for loan losses to $35.8 million at June 30, 2002. The current quarter decline in the allowance reflected a decrease of $1.1 million in allocated allowances to $6.6 million due primarily to a decline in borrowers filing bankruptcy. General valuation allowances declined by $0.4 million and there was no change in our unallocated allowance of $2.8 million.

The following table summarizes the activity in our allowance for loan losses during the periods indicated.

	Three Months Ended				
(In Thousands)	June 30, 2002	March 31, 2002	December 31, 2001	September 30, 2001	June 30 2001
Balance at beginning of period	$ 37,307	$ 36,120	$ 35,043	$ 34,301	$ 34,059
Provision (reduction)	(1,106)	1,447	1,290	791	431
Charge-offs	(387)	(276)	(316)	(198)	(326
Recoveries	20	16	103	149	137
Balance at end of period	$ 35,834	$ 37,307	$ 36,120	$ 35,043	$ 34,301

Since year-end 2001, our allowance for loan losses declined by $0.3 million, as general valuation allowances declined by $1.7 million, partially offset by a $1.4 million increase in allocated allowances.

The following table summarizes the activity in our allowance for loan losses during the periods indicated.

	Six Months Ended June 30,	
(In Thousands)	2002	2001
Balance at beginning of period	$ 36,120	$ 34,452
Provision	341	483
Charge-offs	(663)	(834)
Recoveries	36	200
Balance at end of period	$ 35,834	$ 34,301

The following table presents gross charge-offs, gross recoveries and net charge-offs by category of loan during the periods indicated.

Three Months Ended

(Dollars in Thousands)	June 30, 2002	March 31, 2002	December 31, 2001	September 30 2001
GROSS LOAN CHARGE-OFFS				
Loans secured by real estate:				
Residential:				
One-to-four units	$ 197	$ 125	$ 108	$ 25
One-to-four units - subprime	63	17	70	60
Five or more units	--	--	--	--
Commercial real estate	--	--	--	--
Construction	--	--	--	--
Land	--	--	--	--
Non-mortgage:				
Commercial	--	--	--	--
Automobile	33	52	51	26
Other consumer	94	82	87	87
Total gross loan charge-offs	387	276	316	198
GROSS LOAN RECOVERIES				
Loans secured by real estate:				
Residential:				
One-to-four units	--	9	1	86
One-to-four units - subprime	--	--	100	61
Five or more units	--	--	--	--
Commercial real estate	--	--	--	--
Construction	--	--	--	--
Land	--	--	--	--
Non-mortgage:				
Commercial	--	--	--	--
Automobile	16	5	--	--
Other consumer	4	2	2	2
Total gross loan recoveries	20	16	103	149
NET LOAN CHARGE-OFFS				
Loans secured by real estate:				
Residential:				
One-to-four units	197	116	107	(61)
One-to-four units - subprime	63	17	(30)	(1)
Five or more units	--	--	--	--
Commercial real estate	--	--	--	--
Construction	--	--	--	--
Land	--	--	--	--
Non-mortgage:				
Commercial	--	--	--	--
Automobile	17	47	51	26
Other consumer	90	80	85	85
Total net loan charge-offs	$ 367	$ 260	$ 213	$ 49
Net loan charge-offs as a percentage of average loans	0.01%	0.01%	0.01%	-- %

The following table indicates our allocation of the allowance for loan

losses to the various categories of loans at the dates indicated.

(Dollars in Thousands)	June 30, 2002 Allowance	June 30, 2002 Gross Loan Portfolio Balance	June 30, 2002 Allowance Percentage to Loan Balance	March 31, 2002 Allowance	March 31, 2002 Gross Loan Portfolio Balance	March 31, 2002 Allow Percen to L Bala
Loans secured by real estate:						
Residential:						
One-to-four units	$ 17,291	$8,122,908	0.21%	$ 18,566	$7,869,433	0.24
One-to-four units - subprime.	8,697	1,417,915	0.61	9,755	1,436,760	0.68
Five or more units	65	8,727	0.74	76	10,150	0.75
Commercial real estate	2,905	81,722	3.55	3,367	110,341	3.05
Construction	1,459	124,318	1.17	920	78,202	1.18
Land	769	62,182	1.24	446	36,303	1.23
Non-mortgage:						
Commercial	596	17,371	3.43	511	21,182	2.41
Automobile	250	17,667	1.42	292	20,902	1.40
Other consumer	1,002	50,101	2.00	574	48,067	1.19
Not specifically allocated	2,800	--	--	2,800	--	--
Total loans held for investment	$ 35,834	$9,902,911	0.36%	$ 37,307	$9,631,340	0.39

	September 30, 2001			June 30, 2001		
Loans secured by real estate:						
Residential:						
One-to-four units	$ 16,598	$7,567,462	0.22%	$ 15,139	$7,506,027	0.20
One-to-four units - subprime.	10,385	1,605,994	0.65	10,826	1,701,558	0.64
Five or more units	86	11,489	0.75	141	18,823	0.75
Commercial real estate	2,262	142,480	1.59	2,703	157,749	1.71
Construction	1,164	99,161	1.17	1,171	99,261	1.18
Land	262	21,121	1.24	263	21,283	1.24
Non-mortgage:						
Commercial	650	22,762	2.86	422	21,648	1.95
Automobile	196	29,109	0.67	175	32,594	0.54
Other consumer	640	53,243	1.20	661	56,096	1.18
Not specifically allocated	2,800	--	--	2,800	--	--
Total loans held for investment	$ 35,043	$9,552,821	0.37%	$ 34,301	$9,615,039	0.36

At June 30, 2002, the recorded investment in loans for which we recognized impairment totaled $17 million, unchanged from March 31, 2001, but up from $13 million at December 31, 2001 and $14 million at June 30, 2001. The allowance for losses related to these loans was $2 million at June 30, 2002 and $1 million at both December 31, 2001 and June 30, 2001. During the second quarter of 2002, total interest recognized on the impaired loan portfolio was $0.3 million.

The following table summarizes the activity in our allowance for loan losses associated with impaired loans during the periods indicated.

(In Thousands)	Three Months Ended June 30, 2002	March 31, 2002	December 31, 2001	September 30, 2001	June 30, 2001
Balance at beginning of period	$ 2,356	$ 759	$ 1,210	$ 782	$ 798
Provision (reduction)	(153)	1,597	(451)	428	(16)
Charge-offs	--	--	--	--	--
Recoveries	--	--	--	--	--
Balance at end of period	$ 2,203	$ 2,356	$ 759	$ 1,210	$ 782

For the first six months of 2002, total interest recognized on the impaired loan portfolio was $0.6 million.

The following table summarizes the activity in our allowance for loan losses associated with impaired loans during the periods indicated.

(In Thousands)	Six Months Ended June 30, 2002	2001
Balance at beginning of period	$ 759	$ 800
Provision (reduction)	1,444	(18)
Charge-offs	--	--
Recoveries	--	--
Balance at end of period	$2,203	$ 782

The following table summarizes the activity in our allowance for real estate and joint ventures held for investment during the periods indicated.

(In Thousands)	Three Months Ended June 30, 2002	March 31, 2002	December 31, 2001	September 30, 2001	June 30, 2001
Balance at beginning of period	$ 1,033	$ 2,690	$ 2,689	$ 3,063	$ 3,030
Provision (reduction)	818	(1,318)	1	(374)	33
Charge-offs	--	(339)	--	--	--
Recoveries	--	--	--	--	--
Balance at end of period	$ 1,851	$ 1,033	$ 2,690	$ 2,689	$ 3,063

The following table summarizes the activity in our allowance for real estate and joint ventures held for investment during the periods indicated.

(In Thousands)	Six Months Ended June 30, 2002	2001
Balance at beginning of period	$ 2,690	$ 2,997
Provision (reduction)	(500)	66
Charge-offs	(339)	--
Recoveries	--	--
Balance at end of period	$ 1,851	$ 3,063

CAPITAL RESOURCES AND LIQUIDITY

Our sources of funds include deposits, advances from the FHLB and other borrowings; proceeds from the sale of real estate, loans and mortgage-backed securities; payments of loans and mortgage-backed securities and payments for and sales of loan servicing; and income from other investments. Interest rates, real estate sales activity and general economic conditions significantly affect repayments on loans and mortgage-backed securities and deposit inflows and outflows.

Our primary sources of funds generated in the second quarter of 2002 were from:

- principal repayments--including prepayments, but excluding refinances of our existing loans--on loans and mortgage-backed securities of $814 million;
- maturities and sales of U.S. Treasury securities, agency obligations and other investment securities available for sale of $132 million;
- a net increase in FHLB advances and other borrowings of $93 million; and
- an increase in deposits of $92 million.

We used these funds for the following purposes:

- to originate and purchase loans held for investment, excluding refinances of our existing loans, of $1.067 billion; and
- to purchase U.S. Treasury securities, agency obligations and other investment securities available for sale of $176 million.

Our principal source of liquidity is our ability to utilize borrowings, as needed. Our primary source of borrowings is the FHLB. At June 30, 2002, our FHLB borrowings totaled $1.4 billion, representing 12.7% of total assets. We currently are approved by the FHLB to borrow up to 40% of total assets to the extent we provide qualifying collateral and hold sufficient FHLB stock. That approved limit would have permitted us, as of quarter end, to borrow an additional $3.0 billion. To the extent deposit growth over the remainder of 2002 falls short of satisfying ongoing commitments to fund maturing and withdrawable deposits, repay maturing borrowings, fund existing and future loans, make

investments, and continue branch improvement programs, we will utilize our FHLB borrowing arrangement or possibly other sources. As of June 30, 2002, we had commitments to borrowers for short-term rate locks of $913 million, undisbursed loan funds and unused lines of credit of $189 million, and other contingent liabilities of $3 million. We believe our current sources of funds enable us to meet these obligations while maintaining our liquidity at appropriate levels.

Another measure of liquidity in the savings and loan industry is the ratio of cash and eligible investments to the sum of withdrawable savings and borrowings due within one year. The Bank's ratio was 4.3% at both June 30, 2002 and December 31, 2001 and 5.4% at June 30, 2001.

The holding company currently has liquid assets, including due from Bank--interest bearing balances, of $25 million and can obtain further funds by means of dividends from subsidiaries, subject to certain limitations, or issuance of further debt or equity.

Stockholders' equity totaled $787 million at June 30, 2002, up from $734 million at December 31, 2001 and $681 million at June 30, 2001.

REGULATORY CAPITAL

Our core and tangible capital ratios were both 7.51% and our risk-based capital ratio was 15.16%. The Bank's capital ratios exceed the "well capitalized" standards of 5.00% for core capital and 10.00% for risk-based capital, as defined by regulation.

The following table is a reconciliation of the Bank's stockholder's equity to federal regulatory capital as of June 30, 2002.

	Tangible Capital		Core Capita	
(Dollars in Thousands)	Amount	Ratio	Amount	Ra
Stockholder's equity	$ 878,238		$ 878,238	
Adjustments:				
Deductions:				
Investment in subsidiary, primarily real estate ..	(37,866)		(37,866)	
Excess cost over fair value of branch acquisitions	(2,925)		(2,925)	
Non-permitted mortgage servicing rights	(5,977)		(5,977)	
Additions:				
Unrealized losses on securities available for sale	(236)		(236)	
General loss allowance - investment in DSL Service Company	519		519	
Allowance for loan losses, net of specific allowances (1)	--		--	
Regulatory capital	831,753	7.51%	831,753	7.
Well capitalized requirement	166,111	1.50 (2)	553,703	5.
Excess	$ 665,642	6.01%	$ 278,050	2.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For information regarding quantitative and qualitative disclosures about market risk see Financial Condition-Asset/Liability Management and Market Risk on page 30.

PART II - OTHER INFORMATION

ITEM 1 - LEGAL PROCEEDINGS

We have been named as a defendant in legal actions arising in the ordinary course of business, none of which, in the opinion of management, is material.

ITEM 2 - CHANGES IN SECURITIES AND USE OF PROCEEDS

None.

ITEM 3 - DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4 - SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On April 24, 2002, Downey held its annual meeting of shareholders to elect three Class 1 Directors for terms of three years each and to ratify the Board of Directors' appointment of KPMG LLP as auditors for the year ending December 31, 2002. The number of votes cast at the meeting as to each matter acted upon was as follows:

1. Election of Directors:

Nominees	Votes For	Votes Withheld	Unvoted
Maurice L. McAlister	23,186,095	3,205,225	1,821,728
Sam Yellen	26,183,041	208,279	1,821,728
Daniel D. Rosenthal	26,185,133	206,187	1,821,728

The Directors whose terms continued and the years their terms expire are as follows:

Continuing Directors	Year Term Expires
Cheryl E. Olson	2003
Lester C. Smull	2003
Michael B. Abrahams	2003
Dr. Paul Kouri	2004
Brent McQuarrie	2004

2. Ratification of appointment of KPMG LLP as auditors for the year ending December 31, 2002:

Votes For	Votes Against	Abstain	Unvoted
26,082,208	293,898	15,214	1,821,728

ITEM 5 - OTHER INFORMATION

None.

ITEM 6 - EXHIBITS AND REPORTS ON FORM 8-K

(A) Exhibits

EXHIBIT NUMBER	DESCRIPTION
3.1	(2) Certificate of Incorporation of Downey Financial Corp.
3.2	(1) Bylaws of Downey Financial Corp.
4.1	(4) Junior Subordinated Indenture dated as of July 23, 1999 between Downey Financial Corp. and Wilmington Trust Company as Indenture Trustee.

(A) Exhibits (Continued)

EXHIBIT NUMBER	DESCRIPTION
4.2	(4) 10% Junior Subordinated Debenture due September 15, 2029, Principal Amount $123,711,350.
4.3	(4) Certificate of Trust of Downey Financial Capital Trust I, dated as of May 25, 1999.
4.4	(4) Trust Agreement of Downey Financial Capital Trust I, dated May 25, 1999.
4.5	(4) Amended and Restated Trust Agreement of Downey Financial Capital Trust I, between Downey Financial Corp., Wilmington Trust Company and the Administrative Trustees named therein, dated as of July 23, 1999.
4.6	(4) Certificate Evidencing Common Securities of Downey Financial Capital Trust I, 10% Common Securities.
4.7	(4) Certificate Evidencing Capital Securities of Downey Financial Capital Trust I, 10% Capital Securities (Global Certificate).
4.8	(4) Common Securities Guarantee Agreement of Downey Financial Corp. (Guarantor), dated July 23, 1999.
4.9	(4) Capital Securities Guarantee Agreement of Downey Financial Corp. and Wilmington Trust Company, dated as of July 23, 1999.
10.1	(3) Downey Savings and Loan Association, F.A. Employee Stock Purchase Plan (Amended and Restated as of January 1, 1996).
10.2	(3) Amendment No. 1, Downey Savings and Loan Association, F.A. Employee Stock Purchase Plan. Amendment No. 1, Effective and Adopted January 22, 1997.
10.3	(3) Downey Savings and Loan Association, F.A. Employees' Retirement and Savings Plan (October 1, 1997 Restatement).
10.4	(3) Amendment No. 1, Downey Savings and Loan Association, F.A. Employees' Retirement and Savings Plan (October 1, 1997 Restatement) Amendment No. 1, Effective and Adopted January 28, 1998.
10.5	(3) Trust Agreement for Downey Savings and Loan Association, F.A. Employees' Retirement and Savings Plan, Effective October 1, 1997 between Downey Savings and Loan Association, F.A. and Fidelity Management Trust Company.

10.6 (2) Downey Savings and Loan Association 1994 Long-Term Incentive Plan (as amended).

10.7 (1) Asset Purchase Agreement among Butterfield Savings and Loan Association, FSA, Mortgage Investment, Inc., Property Management Service, Inc. and Butterfield Capital Corporation, dated September 1, 1988.

10.8 (1) Assistance Agreement between and among the Federal Savings and Loan Insurance Corporation, Butterfield Savings and Loan Association, FSA and Downey Savings and Loan Association, dated September 29, 1988 (confidential treatment requested due to contractual prohibition against disclosure).

10.9 (1) Merger of Butterfield Savings and Loan Association, FSA, into Downey Savings and Loan Association, dated September 29, 1989.

10.10(1) Founder Retirement Agreement of Maurice L. McAlister, dated December 21, 1989.

10.11(5) Amendment No. 1, Founders Retirement Agreement of Maurice L. McAlister, dated December 21, 1989. Amendment No. 1, Effective and Adopted July 26, 2000.

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(A) Exhibits (Continued)

EXHIBIT NUMBER	DESCRIPTION
10.12(1)	Founder Retirement Agreement of Gerald H. McQuarrie, dated December 21, 1989.
10.13 (6)	Deferred Compensation Program.
10.14 (6)	Director Retirement Benefits.
99.1	Certification of Chief Executive Officer pursuant to Section 906 of Sarbanes-Oxley Act of 2002.
99.2	Certification of Chief Financial Officer pursuant to Section 906 of Sarbanes-Oxley Act of 2002.

(1) Filed as part of Downey's Registration Statement on Form 8-B/A filed January 17, 1995.
(2) Filed as part of Downey's Registration Statement on Form S-8 filed February 3, 1995.
(3) Filed as part of Downey's report on Form 10-K filed March 16, 1998.
(4) Filed as part of Downey's report on Form 10-Q filed November 2, 1999.
(5) Filed as part of Downey's report on Form 10-Q filed August 2, 2000.
(6) Filed as part of Downey's report on Form 10-K filed March 7, 2001.

We will furnish any or all of the non-confidential exhibits upon payment of a reasonable fee. Please send request for exhibits and/or fee information to:

Downey Financial Corp.
3501 Jamboree Road
Newport Beach, California 92660
Attention: Corporate Secretary

(B) Form 8-K filed April 16, 2002.

SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DOWNEY FINANCIAL CORP.

Date: August 5, 2002 /s/ Daniel D. Rosenthal

Daniel D. Rosenthal
President and Chief Executive Officer

Date: August 5, 2002 /s/ Thomas E. Prince

Thomas E. Prince
Executive Vice President and Chief Financial Officer