HARRIS PREFERRED CAPITAL CORP
Form 10-Q
May 12, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2005

COMMISSION FILE NUMBER 1-13805

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

MARYLAND (State or other jurisdiction of incorporation or organization)	# 36-4183096 (I.R.S. Employer Identification No.)
111 WEST MONROE STREET, CHICAGO, ILLINOIS (Address of principal executive offices)	60603 (Zip Code)

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

SECURITIES REGISTERED PURSUANT TO SECTION 12(B) OF THE ACT:

TITLE OF EACH CLASS	NAME OF EACH EXCHANGE ON WHICH REGISTERED
7 3/8% Noncumulative Exchangeable Preferred Stock, Series A, par value $1.00 per share	New York Stock Exchange

SECURITIES REGISTERED PURSUANT TO SECTION 12(G) OF THE ACT: None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes [X] No [ ]

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

Yes [ ]   No [X]

The number of shares of Common Stock, $1.00 par value, outstanding on May 12, 2005 was 1,000. No common equity is held by nonaffiliates.

HARRIS PREFERRED CAPITAL CORPORATION

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

HARRIS PREFERRED CAPITAL CORPORATION

CONSOLIDATED BALANCE SHEETS

	MARCH 31 2005	DECEMBER 31 2004	MARCH 3 2004
	(UNAUDITED)	(AUDITED)	(UNAUDIT
	(IN THOUSANDS, EXCEPT SHARE DATA)		
ASSETS			
Cash on deposit with Harris Trust and Savings Bank	$ 444	$ 407	$ 56
Securities purchased from Harris Trust and Savings Bank under agreement to resell	11,000	10,500	15,00
Notes receivable from Harris Trust and Savings Bank	11,036	12,129	15,18
Securities available-for-sale:			
Mortgage-backed	440,613	419,315	212,42
U.S. Treasury	24,990	44,993	249,43
Securing mortgage collections due from Harris Trust and Savings Bank	106	78	60
Other assets	1,723	1,600	96

TOTAL ASSETS	$489,912	$489,022	$494,17
LIABILITIES AND STOCKHOLDERS' EQUITY			
Broker payable -- securities purchased	$ 7,331	$ --	$ -
Accrued expenses	103	134	9
TOTAL LIABILITIES	7,434	134	9
Commitments and contingencies	--	--	-
STOCKHOLDERS' EQUITY			
7 3/8% Noncumulative Exchangeable Preferred Stock, Series A ($1 par value); liquidation value of $250,000,000 and 20,000,000 shares authorized, 10,000,000 shares issued and outstanding	250,000	250,000	250,00
Common stock ($1 par value); 1,000 shares authorized, issued and outstanding	1	1	
Additional paid-in capital	240,733	240,733	240,73
Earnings in excess of (less than) distributions	(550)	(582)	26
Accumulated other comprehensive income (loss) -- net unrealized gains/(losses) on available-for-sale securities	(7,706)	(1,264)	3,07
TOTAL STOCKHOLDERS' EQUITY	482,478	488,888	494,07
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$489,912	$489,022	$494,17

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

HARRIS PREFERRED CAPITAL CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS
AND COMPREHENSIVE INCOME
(UNAUDITED)

	QUARTER ENDED MARCH 31	
	2005	2004
	(IN THOUSANDS, EXCEPT PER SHARE DATA)	
INTEREST INCOME:		
Securities purchased from Harris Trust and Savings Bank under agreement to resell	$ 200	$ 471
Notes receivable from Harris Trust and Savings Bank	184	258
Securities available-for-sale:		
Mortgage-backed	4,566	2,630
U.S. Treasury	19	24
Total interest income	4,969	3,383
NON-INTEREST INCOME:		
(Loss) gain on sale of securities	(194)	398

OPERATING EXPENSES:		
Loan servicing fees paid to Harris Trust and Savings Bank	8	12
Advisory fees paid to Harris Trust and Savings Bank	24	29
General and administrative	102	96
Total operating expenses	134	137
Net income	4,641	3,644
Preferred dividends	4,609	4,609
NET INCOME (LOSS) AVAILABLE TO COMMON STOCKHOLDER	$ 32	$ (965)
Basic and diluted earnings (loss) per common share	$ 32.00	$(965.00)
Net income	$ 4,641	$ 3,644
Other comprehensive income (loss) -- net unrealized gains/(losses) on available-for-sale securities	(6,442)	806
Comprehensive income (loss)	$(1,801)	$ 4,450

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

HARRIS PREFERRED CAPITAL CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(UNAUDITED)

	QUARTER ENDED MARCH 31	
	2005	2004
	(IN THOUSANDS, EXCEPT PER SHARE DATA)	
Balance at January 1	$488,888	$494,234
Net income	4,641	3,644
Other comprehensive income (loss)	(6,442)	806
Dividends (preferred stock $0.4609 per share)	(4,609)	(4,609)
Balance at March 31	$482,478	$494,075

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

HARRIS PREFERRED CAPITAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	QUARTER ENDED MARCH 31	
	2005	2004
	(IN THOUSANDS)	
OPERATING ACTIVITIES:		
Net Income	$ 4,641	$ 3,644
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss (gain) on sale of securities	194	(398)
Net (increase) decrease in other assets	(123)	117
Net (decrease) increase in accrued expenses	(11)	13
Net cash provided by operating activities	4,701	3,376
INVESTING ACTIVITIES:		
Net decrease in securities purchased from Harris Trust and Savings Bank under agreement to resell	(500)	(3,500)
Repayments of notes receivable from Harris Trust and Savings Bank	1,093	1,363
Increase in securing mortgage collections due from Harris Trust and Savings Bank	(28)	(189)
Purchases of securities available-for-sale	(65,953)	(250,000)
Proceeds from sales of securities available-for-sale	--	10,989
Proceeds from maturities of securities available-for-sale	65,333	242,206
Net cash (used) provided by investing activities	(55)	869
FINANCING ACTIVITIES:		
Cash dividends paid on preferred stock	(4,609)	(4,609)
Net increase (decrease) in cash on deposit with Harris Trust and Savings Bank	37	(364)
Cash on deposit with Harris Trust and Savings Bank at beginning of period	407	926
Cash on deposit with Harris Trust and Savings Bank at end of period	$ 444	$ 562
NON CASH TRANSACTION		
Unsettled security purchase	$ 7,331	$ --

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

HARRIS PREFERRED CAPITAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

Harris Preferred Capital Corporation (the "Company") is a Maryland corporation whose principal business objective is to acquire, hold, finance and manage qualifying real estate investment trust ("REIT") assets (the "Mortgage Assets"), consisting of a limited recourse note or notes (the "Notes") issued by

Harris Trust and Savings Bank (the "Bank") secured by real estate mortgage assets (the "Securing Mortgage Loans") and other obligations secured by real property, as well as certain other qualifying REIT assets, primarily U.S. treasury securities and securities collateralized with real estate mortgages. The Company holds its assets through a Maryland real estate investment trust subsidiary, Harris Preferred Capital Trust. Harris Capital Holdings, Inc., owns 100% of the Company's common stock. The Bank owns all common stock outstanding issued by Harris Capital Holdings, Inc.

The accompanying consolidated financial statements have been prepared by management from the books and records of the Company. These statements reflect all adjustments and disclosures which are, in the opinion of management, necessary for a fair presentation of the results for the interim periods presented and should be read in conjunction with the notes to financial statements included in the Company's 2004 Form 10-K. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission.

2. COMMITMENTS AND CONTINGENCIES

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

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

FORWARD-LOOKING INFORMATION

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

RESULTS OF OPERATIONS

FIRST QUARTER 2005 COMPARED WITH FIRST QUARTER 2004

The Company's net income for the first quarter of 2005 was $4.6 million. This represented a $1 million or 27% increase from first quarter 2004 earnings of $3.6 million. Earnings increased primarily because of increased interest income on earning assets.

HARRIS PREFERRED CAPITAL CORPORATION

First quarter 2005 interest income on the Notes totaled $184 thousand and yielded 6.4% on $11.5 million of average principal outstanding for the quarter compared to $258 thousand and a 6.4% yield on $16.1 million average principal outstanding for first quarter 2004. The decrease in income was attributable to a reduction in the Notes balance because of principal paydowns by customers in the Securing Mortgage Loans. The average outstanding balance of the Securing Mortgage Loans for first quarter 2005 and 2004 was $14 million and $20 million, respectively. Interest income on securities available-for-sale for the current quarter was $4.6 million resulting in a yield of 4.2% on an average balance of $436 million, compared to $2.7 million with a yield of 4.4% on an average balance of $243 million for the same period a year ago. The increase in interest income is primarily attributable to the increase in the investment portfolio of mortgage-backed securities.

There were no Company borrowings during first quarter 2005 or 2004.

First quarter 2005 operating expenses totaled $134 thousand, a decrease of $3 thousand or 2% from the first quarter of 2004. Loan servicing expenses totaled $8 thousand, a decrease of $4 thousand from a year ago. This decrease is attributable to the reduction in the principal balance of the Notes, thereby reducing servicing fees payable to the Bank. Advisory fees for the first quarter 2005 were $24 thousand compared to $29 thousand a year earlier. General and administrative expenses totaled $102 thousand, an increase of $6 thousand over the same period in 2004 as a result of higher costs for processing, recordkeeping and administration.

At March 31, 2005 and 2004, there were no Securing Mortgage Loans on nonaccrual status.

On March 30, 2005, the Company paid a cash dividend of $0.46094 per share on outstanding preferred shares to the stockholders of record on March 15, 2005 as declared on March 2, 2005. On March 31, 2004, the Company paid a cash dividend of $0.46094 per share on outstanding preferred shares to the stockholders of record on March 15, 2004, as declared on March 2, 2004.

At March 31, 2005, net unrealized losses on available-for-sale securities were $7.7 million compared to $3.1 million of unrealized gains at March 31, 2004 and $1.3 million of unrealized losses at December 31, 2004. The unrealized loss position at March 31, 2005 was attributable to changes in interest rates and not to lowered credit quality of individual securities.

LIQUIDITY RISK MANAGEMENT

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

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

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

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

As presented in the accompanying Consolidated Statements of Cash Flows, the primary sources of funds in addition to $4.7 million provided from operations during the three months ended March 31, 2005 were $1.1 million provided by principal repayments on the Notes and $65.3 million from the maturities of securities available-for-sale. In the prior period ended March 31, 2004, the primary sources of funds other than $3.4 million from operations were $1.4 million provided by principal repayments on the Notes and $253.2 million from the maturities and sales of securities available-for-sale. The primary uses of funds for the three months ended March 31, 2005 were $65.9 million for purchases of securities available-for-sale and $4.6 million in preferred stock dividends paid. For the prior year's quarter ended March 31, 2004, the primary uses of funds were $250.0 million for purchases of securities available-for-sale and $4.6 million in preferred stock dividends paid.

MARKET RISK MANAGEMENT

The Company's market risk is composed primarily of interest rate risk. There have been no material changes in market risk or the manner in which the Company manages market risk since December 31, 2004.

OTHER MATTERS

As of March 31, 2005, the Company believes that it is in full compliance with the REIT tax rules, and expects to qualify as a non-taxable REIT under the provisions of the Internal Revenue Code. The Company expects to meet all REIT requirements regarding the ownership of its stock and anticipates meeting the annual distribution requirements.

On June 4, 2004, Harris Bankcorp, Inc., the Bank's parent company, announced its plan to consolidate twenty-six of its separate bank subsidiaries in Illinois (including the Bank) into one national bank, Harris N.A. This transaction is expected to be completed in May 2005. After that time, each outstanding share of the Company's Series A Preferred Stock will be automatically exchangeable for one newly issued preferred share of Harris N.A. under the same exchange conditions currently in existence for preferred shares of the Bank, except that the primary regulator for purposes of the exchange conditions will be the Office of the Comptroller of the Currency, rather than the Board of Governors of the Federal Reserve Bank. References herein to the Bank for those times subsequent to the charter consolidation are intended to refer to Harris N.A.

FINANCIAL STATEMENTS OF HARRIS TRUST AND SAVINGS BANK

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

HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CONDITION

	MARCH 31 2005 (UNAUDITED)	DECEMBER 31 2004 (AUDITED)	MARCH 2004 (UNAUDI
	(IN THOUSANDS EXCEPT SHARE DATA)		
ASSETS			
Cash and demand balances due from banks	$ 742,127	$ 887,827	$ 904
Money market assets:			
Interest-bearing deposits at banks	735,022	662,366	515
Federal funds sold	544,352	541,300	524
Securities available-for-sale (including $3.22 billion, $3.36 billion, and $3.09 billion of securities pledged as collateral for repurchase agreements at March 31, 2005, December 31, 2004 and March 31, 2004, respectively)	5,957,831	5,784,417	7,133
Trading account assets	122,605	90,130	49
Loans	12,309,038	11,484,948	10,317
Allowance for loan losses	(212,261)	(219,740)	(244
Net loans	12,096,777	11,265,208	10,073
Premises and equipment	258,994	309,415	303
Bank-owned insurance	1,082,906	1,072,660	1,044
Loans held for sale	18,437	43,423	119
Goodwill and other intangible assets	153,001	155,596	163
Other assets	497,305	412,305	604
TOTAL ASSETS	$22,209,357	$21,224,647	$21,437
LIABILITIES			
Deposits in domestic offices -- noninterest-bearing	$ 4,253,312	$4,019,416	$ 4,316
-- interest-bearing	8,839,330	8,149,640	8,669
Deposits in foreign offices -- noninterest-bearing	--	--	4
-- interest-bearing	1,278,247	1,677,428	1,055
Total deposits	14,370,889	13,846,484	14,046
Federal funds purchased and securities sold under agreement to repurchase	3,829,890	4,566,879	4,321
Short-term borrowings	636,343	88,070	101
Short-term senior notes	750,000	200,000	200
Accrued interest, taxes and other expenses	165,742	165,618	160
Other liabilities	351,858	264,134	500
Minority interest-preferred stock of subsidiary	250,000	250,000	250
Preferred stock issued to Harris Bankcorp, Inc.	5,000	5,000	5
Long-term notes -- subordinated	200,000	200,000	225
TOTAL LIABILITIES	20,559,722	19,586,185	19,809

STOCKHOLDER'S EQUITY

Common stock ($10 par value); 10,100,000, 10,100,000 and 10,000,000 shares authorized, issued and outstanding at

March 31, 2005, December 31,2004 and March 31, 2004, respectively	101,000	101,000	100
Surplus	649,929	647,365	642
Retained earnings	958,870	941,767	888
Accumulated other comprehensive loss	(60,164)	(51,670)	(2
TOTAL STOCKHOLDER'S EQUITY	1,649,635	1,638,462	1,628
TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY	$22,209,357	$21,224,647	$21,437

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

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HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

	QUARTER ENDED MARCH 31	
	2005	2004
	(IN THOUSANDS)	
INTEREST INCOME		
Loans, including fees	$153,683	$121,170
Money market assets:		
Deposits at banks	2,204	877
Federal funds sold and securities purchased under agreement to resell	4,515	1,448
Trading accounts	1,128	372
Securities available-for-sale:		
U.S. Treasury and federal agency	26,834	33,436
State and municipal	368	279
Other	3,889	686
Total interest income	192,621	158,268
INTEREST EXPENSE		
Deposits	55,194	34,875
Short-term borrowings	26,864	9,928
Senior notes	1,741	126
Minority interest-dividends on preferred stock of subsidiary	4,609	4,609
Long-term notes	1,477	2,578
Total interest expense	89,885	52,116
NET INTEREST INCOME	102,736	106,152
Provision for loan losses	--	17,325
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	102,736	88,827
NONINTEREST INCOME		

Trust and investment management fees	23,397	23,052
Money market and bond trading	2,590	2,113
Foreign exchange	1,215	1,725
Service charges and fees	23,313	25,103
Net securities (losses) gains	(236)	11,495
Bank-owned insurance	10,246	10,388
Gains from loan restructuring	--	7,131
Letter of credit fees	5,486	6,150
Other	42,929	49,453
Total noninterest income	108,940	136,610
NONINTEREST EXPENSES		
Salaries and other compensation	72,801	74,299
Pension, profit sharing and other employee benefits	20,569	20,694
Net occupancy	12,112	11,929
Equipment	12,647	13,125
Marketing	8,034	8,292
Communication and delivery	5,648	5,615
Expert services	6,041	5,601
Contract programming	7,468	8,291
Other	30,263	25,863
	175,583	173,709
Amortization of intangibles	2,596	2,596
Total noninterest expenses	178,179	176,305
Income before income taxes	33,497	49,132
Applicable income taxes	8,349	14,057
NET INCOME	$ 25,148	$ 35,075

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

HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

	QUARTER ENDED MARCH 31	
	2005	2004
	(IN THOUSANDS)	
Net income	$25,148	$35,075
Other comprehensive loss:		
Cash flow hedges:		
Net unrealized loss on derivative instruments, net of tax benefit of $5,332 in 2005 and $80 in 2004	(9,080)	(137)
Minimum pension liability adjustment net of tax benefit of zero in 2005 and $78 in 2004	--	(122)

Unrealized gains (losses) on available-for-sale securities:		
Unrealized holding gains arising during the period, net of tax expense of $224 in 2005 and $2,504 in 2004.....	442	2,843
Less reclassification adjustment for realized losses (gains) included in net income, net of tax (benefit) expense of ($92) in 2005 and $4,474 in 2004..........	144	(7,021)
Other comprehensive loss................................	(8,494)	(4,437)
Comprehensive income....................................	$16,654	$30,638

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

HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

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

	2005	2004
	(IN THOUSANDS)	
BALANCE AT JANUARY 1....................................	$1,638,462	$1,596,629
Net income..	25,148	35,075
Contributions to capital................................	2,564	2,989
Contribution of parent's banking assets.................	--	14,984
Dividends -- preferred stock............................	(45)	(108)
Dividends -- common stock...............................	(8,000)	(17,000)
Other comprehensive loss................................	(8,494)	(4,437)
BALANCE AT MARCH 31.....................................	$1,649,635	$1,628,132

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

HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	QUARTER ENDED MARCH 31	
	2005	2004
	(IN THOUSANDS)	

OPERATING ACTIVITIES:		
Net Income	$ 25,148	$ 35,075
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	--	17,325
Depreciation and amortization, including intangibles	14,583	16,862
Deferred tax expense (benefit)	2,195	(2,416)
Net loss (gain) on sales of securities	236	(11,281)
Increase in bank-owned insurance	(10,246)	(10,126)
Trading account net cash (purchases) sales	(33,157)	31,543
Net increase in interest receivable	(8,250)	(2,195)
Net increase (decrease) in interest payable	3,544	(4,387)
Net decrease in loans held for sale	24,986	49,778
Other, net	(2,451)	(25,981)
Net cash provided by operating activities	16,588	94,197
INVESTING ACTIVITIES:		
Net increase in interest-bearing deposits at banks	(72,656)	(90,731)
Net increase in Federal funds sold and securities purchased under agreement to resell	(3,052)	(109,371)
Proceeds from sales of securities available-for-sale	14,534	799,667
Proceeds from maturities of securities available-for-sale	752,449	927,286
Purchases of securities available-for-sale	(946,057)	(1,990,549)
Net increase in loans	(834,760)	(625,746)
Purchases of premises and equipment	(15,094)	(10,898)
Other, net	107,859	409
Net cash used by investing activities	(996,777)	(1,099,933)
FINANCING ACTIVITIES:		
Cash received in contribution of parent's banking assets	--	3,379
Net increase in deposits	481,205	1,140,897
Net decrease in Federal funds purchased and securities sold under agreement to repurchase	(736,989)	(331,271)
Net increase in other short-term borrowings	548,273	90,776
Proceeds from issuance of senior notes	750,000	200,000
Repayment of senior notes	(200,000)	--
Cash dividends paid on common stock	(8,000)	(17,000)
Net cash provided by financing activities	834,489	1,086,781
NET (DECREASE) INCREASE IN CASH AND DEMAND BALANCES DUE FROM BANKS	(145,700)	81,045
CASH AND DEMAND BALANCES DUE FROM BANKS AT JANUARY 1	887,827	823,615
CASH AND DEMAND BALANCES DUE FROM BANKS AT MARCH 31	$ 742,127	$ 904,660

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

HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

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

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

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

2. LEGAL PROCEEDINGS

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

3. CASH FLOWS

For purposes of the Bank's Consolidated Statements of Cash Flows, cash and cash equivalents is defined to include cash and demand balances due from banks. Cash interest payments for the three months ended March 31 totaled $86.3 million and $56.4 million in 2005 and 2004, respectively. Cash income tax payments over the same periods totaled $11.2 million and $0.5 million, respectively.

4. GOODWILL AND OTHER INTANGIBLE ASSETS

The Bank records goodwill and other intangible assets in connection with the acquisition of assets from unrelated parties or the acquisition of new subsidiaries. Goodwill and other intangible assets that have indefinite useful lives are not subject to amortization while intangible assets with finite lives are amortized. Goodwill is periodically assessed for impairment, at least annually. Intangible assets with finite lives are amortized on either an accelerated or straight-line basis depending on the character of the acquired asset. Intangible assets with finite lives are reviewed for impairment when events or future assessments of profitability indicate that the carrying value may not be recoverable.

The carrying value of the Bank's goodwill was $89.3 million as of March 31, 2005 and 2004. No impairment was recorded during the quarter ended March 31, 2005.

Besides goodwill, the Bank did not have any intangible assets not subject to amortization as of March 31, 2005 and 2004.

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HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

As of March 31, 2005, the gross carrying amount and accumulated amortization of the Bank's amortizable intangible assets are included in the following table.

	MARCH 31, 2005		MARCH 31, 2005	MARCH 31, 2004
	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	NET CARRYING VALUE	NET CARRYIN VALUE
	(IN THOUSANDS)			
Branch network	$145,000	$(84,584)	$60,416	$70,083
Other	5,724	(2,463)	3,261	3,976
Total finite life intangibles	$150,724	$(87,047)	$63,677	$74,059

Total amortization expense for the Bank's intangible assets was $2.6 million for the quarters ended March 31, 2005 and 2004.

Estimated intangible asset amortization expense is $10.4 million for each of the years ending December 31, 2005, 2006, 2007 and 2008 and $9.9 million for the year ending December 31, 2009.

5. BUSINESS COMBINATIONS

On June 4, 2004, Harris Bankcorp, Inc. announced its plan to consolidate twenty-six of its existing bank charters, including the Bank, into one national bank charter, Harris N.A. This transaction is expected to be completed in May 2005. The combination will be recorded at historical carrying value and, where applicable, prior years' financial statements will be restated. The following information is presented to illustrate the relative magnitude of the combination.

	ACTUAL MARCH 31, 2005 BALANCES FOR HARRIS TRUST AND SAVINGS BANK	PROFORMA COMBINED BALANCES OF HARRIS N.A. AT MARCH 31, 2005
	(IN MILLIONS)	
Assets	$24,885	$35,351
Deposits	12,914	22,134
Equity	1,655	2,639

6. SALE OF BUILDING

On March 1, 2005, the Bank sold to a third party the land and building located at 111 W. Monroe Street in Chicago. Upon sale, the Bank entered into a leaseback agreement for approximately 50 percent of the building space with an average lease term of 16 years. The leaseback agreement meets the criteria to be recorded as an operating lease. The sale resulted in a gain of $55.8 million, all of which will be deferred and amortized over the term of the leaseback.

HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

FINANCIAL REVIEW

FIRST QUARTER 2005 COMPARED WITH FIRST QUARTER 2004

SUMMARY

The Bank had first quarter 2005 net income of $25.1 million, a decrease of $9.9 million or 28 percent from first quarter 2004.

Cash ROE was 7.26 percent in the current quarter and 10.17 percent in first quarter 2004. Excluding unrealized gains and losses on the securities portfolio recorded directly to equity, cash ROE was 7.15 percent for the current year's first quarter, compared to 10.38 percent a year ago.

First quarter net interest income on a fully taxable equivalent basis was $104.8 million, down $3.8 million or 3 percent from $108.6 million in 2004's first quarter. Average earning assets increased 10 percent to $18.97 billion from $17.29 billion in 2004. Average loans increased $1.75 billion. Net interest margin decreased to 2.23 percent from 2.52 percent in the same quarter last year reflecting the impact of higher rates on deposits, the issuance of higher-cost incremental supporting funds and little change in the yield from the securities portfolio. These were somewhat offset by higher yields in the loan portfolio and a higher loan base.

In the first quarter 2005, the Bank recorded no provision for loan losses. The first quarter 2004 provision for loan losses was $17.3 million. Net charge-offs were $7.5 million compared to $9.3 million in the prior year's quarter. The decrease in the provision was a result of lower levels of non-performing loans and an improvement in the credit profile of the loan portfolio.

First quarter 2005 noninterest income of $108.9 million decreased $27.7 million from the same quarter last year. Net gains from sales of securities decreased $11.7 million. In first quarter 2004, the Bank experienced a $7.1 million gain on the sale of assets received in an earlier troubled debt restructuring and a $7.7 million gain on the termination of a swap.

First quarter 2005 noninterest expenses of $178.2 million increased $1.9 million or 1 percent from the year-ago quarter. The increase included higher outsourced administrative and technology expenses. Salary expense decreased from the prior year's first quarter.

Nonperforming assets at March 31, 2005 were $134 million or 1.09 percent of total loans, compared to $125 million or 1.09 percent at December 31, 2004 and $159 million or 1.56 percent a year ago. At March 31, 2005, the allowance for loan losses was $212 million, equal to 1.72 percent of loans outstanding, compared to $244 million or 2.45 percent at the end of first quarter 2004. As a result, the ratio of the allowance for loan losses to nonperforming assets was 158 percent at March 31, 2005 compared to 153 percent at March 31, 2004.

At March 31, 2005, Tier 1 capital of the Bank amounted to $1.78 billion, up from $1.68 billion one year earlier. The regulatory leverage capital ratio was 8.20 percent for the first quarter of 2005 compared to 8.51 percent in the same quarter of 2004. The Bank's capital ratio exceeds the prescribed regulatory minimum for banks. The Bank's March 31, 2005 Tier 1 and total risk-based capital ratios were 9.03 percent and 11.12 percent compared to respective ratios of 9.86 percent and 11.81 percent at March 31, 2004.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

ITEM 4. CONTROLS AND PROCEDURES

As of March 31, 2005, Paul R. Skubic, the Chairman of the Board, Chief Executive Officer and President of the Company, and Janine Mulhall, the Chief Financial Officer of the Company, evaluated the effectiveness of the disclosure controls and procedures of the Company and concluded that these disclosure controls and procedures are effective to ensure that material information required to be included in this Report has been recorded, processed, summarized and made known to them in a timely fashion, as appropriate to allow timely discussion regarding disclosures. There was no change in the Company's internal controls over financial reporting identified in connection with such evaluations that occurred during the quarter ended March 31, 2005 that has materially affected or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

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

ITEM 6. EXHIBITS

31.1 CERTIFICATION OF JANINE MULHALL PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

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

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

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, Harris Preferred Capital Corporation has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized on the 12th day of May 2005.

/s/ PAUL R. SKUBIC

Paul R. Skubic
Chairman of the Board and President

/s/ JANINE MULHALL

Janine Mulhall
Chief Financial Officer

EXHIBIT INDEX

EXHIBIT	DESCRIPTION
31.1	Certification of Janine Mulhall pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Paul R. Skubic pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002