HARRIS PREFERRED CAPITAL CORP
Form 10-Q
August 14, 2002

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2002

COMMISSION FILE NUMBER 1-13805

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

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

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

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

The number of shares of Common Stock, $1.00 par value, outstanding on August 14, 2002 was 1,000.

HARRIS PREFERRED CAPITAL CORPORATION
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HARRIS PREFERRED CAPITAL CORPORATION
BALANCE SHEETS
(UNAUDITED)

	JUNE 30, 2002	DECEMBER 31, 2001	JUNE 200
	(IN THOUSANDS, EXCEPT SHARE DATA		
ASSETS			
Cash on deposit with Harris Trust and Savings Bank	$ 314	$ 506	$
Securities purchased from Harris Trust and Savings Bank under agreement to resell	15,000	21,000	10,
Notes receivable from Harris Trust and Savings Bank	41,375	55,962	78,
Securities available-for-sale:			
Mortgage-backed	198,125	319,644	376,
U.S. Treasury	174,947	84,932	24,
Securing mortgage collections due from Harris Trust and Savings Bank	2,243	5,353	2,
Broker receivable -- due from securities sales	63,624	--	
Other assets	1,229	1,945	2,
TOTAL ASSETS	$496,857	$489,342	$496,
LIABILITIES AND STOCKHOLDERS' EQUITY			
Accrued expenses	$ 44	$ 100	$
Commitments and contingencies	--	--	
STOCKHOLDERS' EQUITY			
7 3/8% Noncumulative Exchangeable Preferred Stock, Series A ($1 par value); liquidation value of $250,000; 20,000,000 shares authorized, 10,000,000 shares issued and outstanding	250,000	250,000	250,
Common stock ($1 par value); 1,000 shares authorized, issued and outstanding	1	1	
Additional paid-in capital	240,733	240,733	240,
Earnings in excess of distributions	4,266	385	8,

Accumulated other comprehensive income (loss) -- unrealized gains (losses) on available-for-sale securities.....	1,813	(1,877)	(3,
TOTAL STOCKHOLDERS' EQUITY.....	496,813	489,242	496,
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY.....	$496,857	$489,342	$496,

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

HARRIS PREFERRED CAPITAL CORPORATION

STATEMENTS OF OPERATIONS
AND COMPREHENSIVE INCOME
(UNAUDITED)

	QUARTER ENDED JUNE 30		SIX MONTHS ENDED	
	2002	2001	2002	
	(IN THOUSANDS, EXCEPT PER SHARE DATA)			
INTEREST INCOME:				
Securities purchased from Harris Trust and Savings Bank under agreement to resell.....	$ 638	$ 372	$ 959	$
Notes receivable from Harris Trust and Savings Bank.....	740	1,382	1,585	
Securities available-for-sale:				
Mortgage-backed.....	3,235	5,850	7,917	
U.S. Treasury.....	73	120	170	
Total interest income.....	4,686	7,724	10,631	
NON-INTEREST INCOME:				
Gain on sale of securities.....	2,695	--	2,695	
OPERATING EXPENSES:				
Loan servicing fees paid to Harris Trust and Savings Bank.....	34	64	75	
Advisory fees paid to Harris Trust and Savings Bank.....	19	8	27	
General and administrative.....	48	34	125	
Total operating expenses.....	101	106	227	
Net income.....	7,280	7,618	13,099	
Preferred dividends.....	4,609	4,609	9,218	
NET INCOME AVAILABLE TO COMMON STOCKHOLDER.....	$ 2,671	$ 3,009	$ 3,881	$
Basic and diluted earnings per common share.....	$2,671.00	$3,009.00	$3,881.00	$
Net income.....	$ 7,280	$ 7,618	$ 13,099	$
Other comprehensive income (loss) --				

unrealized gains (losses) on available-for-sale securities.....	6,208	(2,031)	3,690
Comprehensive income.....	$ 13,488	$ 5,587	$ 16,789

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

HARRIS PREFERRED CAPITAL CORPORATION

STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(UNAUDITED)

	SIX MONTHS ENDED JUNE 30	
	2002	2001
	(IN THOUSANDS, EXCEPT PER SHARE DATA)	
Balance at January 1.....	$489,242	$489,824
Net income.....	13,099	17,524
Other comprehensive income (loss).....	3,690	(1,642)
Dividends (preferred stock $0.4609 per share).....	(9,218)	(9,218)
Balance at June 30.....	$496,813	$496,488

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

HARRIS PREFERRED CAPITAL CORPORATION
STATEMENTS OF CASH FLOWS
(UNAUDITED)

	SIX MONTHS ENDED JUNE 30	
	2002	2001
	(IN THOUSANDS)	
OPERATING ACTIVITIES:		
Net Income.....	$ 13,099	$ 17,524
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sale of securities.....	(2,695)	(2,203)
Net decrease in other assets.....	716	59
Net increase in broker receivable -- due from securities sales.....	(63,624)	--

Net decrease in accrued expenses	(56)	(71)
Net cash (used) provided by operating activities	(52,560)	15,309
INVESTING ACTIVITIES:		
Net decrease (increase) in securities purchased from Harris Trust and Savings Bank under agreement to resell	6,000	(7,001)
Repayments of notes receivable from Harris Trust and Savings Bank	14,587	24,038
Decrease in securing mortgage collections due from Harris Trust and Savings Bank	3,110	21
Purchases of securities available-for-sale	(371,585)	(213,589)
Proceeds from maturities and sales of securities available-for-sale	409,474	190,161
Net cash provided (used) in investing activities	61,586	(6,370)
FINANCING ACTIVITIES:		
Cash dividends paid on preferred stock	(9,218)	(9,218)
Net decrease in cash on deposit with Harris Trust and Savings Bank	(192)	(279)
Cash on deposit with Harris Trust and Savings Bank at beginning of period	506	819
Cash on deposit with Harris Trust and Savings Bank at end of period	$ 314	$ 540

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

HARRIS PREFERRED CAPITAL CORPORATION
NOTES TO FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

Harris Preferred Capital Corporation (the "Company") is a Maryland corporation whose principal business objective is to acquire, hold, finance and manage qualifying real estate investment trust ("REIT") assets (the "Mortgage Assets"), consisting of a limited recourse note or notes (the "Notes") issued by Harris Trust and Savings Bank (the "Bank") secured by real estate mortgage assets (the "Securing Mortgage Loans") and other obligations secured by real property, as well as certain other qualifying REIT assets. The Company holds its assets through a Maryland real estate investment trust subsidiary, Harris Preferred Capital Trust. Harris Capital Holdings, Inc., a wholly-owned subsidiary of the Bank, owns 100% of the Company's common stock.

The accompanying financial statements have been prepared by management from the books and records of the Company, without audit by independent certified public accountants. These statements reflect all adjustments and disclosures which are, in the opinion of management, necessary for a fair statement of the results for the interim periods presented and should be read in conjunction with the notes to financial statements included in the Company's 2001 Form 10-K. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission.

2. COMMITMENTS AND CONTINGENCIES

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

3. ACCOUNTING PRONOUNCEMENTS

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

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

In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." The Statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The Statement requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable

estimate of fair value can be made. The associated asset retirement costs should be capitalized as part of the carrying amount of the long-lived asset. The Statement is effective for financial statements issued for fiscal years beginning after June 15, 2002. The Company does not expect the implementation of this Statement to have a material effect on its financial position or results of operations.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." The Statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets and establishes a single accounting model for long-lived assets to be disposed of by sale. It supersedes SFAS No. 121 and the accounting and reporting provisions of APB Opinion No. 30 for the disposal of a segment of a business. The Statement is effective for financial statements issued for fiscal years beginning after

December 15, 2001 and interim periods within those fiscal years. The implementation of this Statement has not had a material effect on the Company's financial position or results of operations.

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

SECOND QUARTER 2002 COMPARED WITH SECOND QUARTER 2001

The Company's net income for the second quarter of 2002 was $7.3 million. This represented a $.3 million or 4.4% decrease from second quarter 2001 earnings of $7.6 million. Earnings decreased primarily because of reduced interest income on earning assets. As assets mature or are sold, proceeds have been invested in lower yielding securities because market interest rates have been declining in the past twelve months.

Second quarter 2002 interest income on the Notes totaled $740 thousand and yielded 6.4% on $46.3 million of average principal outstanding for the quarter compared to $1.4 million and a 6.4% yield on $86.3 million average principal outstanding for second quarter 2001. The decrease in income was attributable to a reduction in the Notes balance because of customer payoffs on the Securing Mortgage Loans. The average outstanding balance of the Securing Mortgage Loans for second quarter 2002 and 2001 was $57 million and $106 million, respectively. Interest income on securities available-for-sale for the current quarter was $3.3 million resulting in a yield of 5.4% on an average balance of $245 million, compared to $6.0 million with a yield of 6.6% on an average balance of $365 million for the same period a year ago. The decrease in interest income is primarily attributable to the reduction in yield. As securities mature or are sold,

proceeds have been invested in lower yielding securities because market interest rates have been declining in the past twelve months. Gains from investment

securities sales were $2.7 million in second quarter 2002. No security gains or losses were realized in the second quarter 2001.

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

Second quarter 2002 operating expenses totaled $101 thousand, a decrease of $5 thousand or 5% from the second quarter of 2001. Loan servicing expenses totaled $34 thousand, a decrease of $30 thousand or 47% from a year ago. This decrease is attributable to the reduction in the principal balance of the Notes, thereby reducing servicing fees payable to the Bank. Advisory fees for the second quarter 2002 were $19 thousand compared to $8 thousand a year earlier, primarily attributable to increased securities processing costs in the current year. General and administrative expenses totaled $48 thousand, an increase of $14 thousand over second quarter 2001, primarily due to increased expenses related to financial reporting and compliance.

At June 30, 2002 and 2001, there were no Securing Mortgage Loans on nonaccrual status.

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

SIX MONTHS ENDED JUNE 30, 2002 COMPARED WITH JUNE 30, 2001

The Company's net income for the six months ended June 30, 2002 was $13.1 million. This represented a $4.4 million or 25% decrease from 2001 earnings of $17.5 million. Earnings decreased primarily because of reduced interest income on earning assets. As assets mature or are sold, proceeds have been invested in lower yielding securities because market interest rates have been declining in the past twelve months.

Interest income on securities purchased under agreement to resell for the six months ended June 30, 2002 was $959 thousand, an increase of $44 thousand from the same period in 2001. Interest income on the Notes for the six months ended June 30, 2002 totaled $1.6 million and yielded 6.40% on $50 million of average principal outstanding compared to $3.0 million of income yielding 6.40% on $93 million of average principal outstanding for the same period in 2001. The decrease in income was attributable to a reduction in the Note balance because of customer payoffs on the Securing Mortgage Loans. There were no Company borrowings during either period. Interest income on securities available-for-sale for the six months ended June 30, 2002 was $8.1 million resulting in a yield of 5.58% on an average balance of $290 million, compared to $11.7 million of income with a yield of 6.57% on an average balance of $356 million a year ago. The decrease in interest income is primarily attributable to the reduction in yield. As securities mature or are sold, proceeds have been invested in lower yielding securities as a result of market interest rates declining in recent months. Gains from investment securities sales for the six months ended June 30, 2002 were $2.7 million compared to $2.2 million a year ago. The average outstanding balance of the Securing Mortgage Loans was $61 million for the six months ended June 30, 2002 and $114 million for the same period in 2001.

Operating expenses for the six months ended June 30, 2002 totaled $227 thousand, a decrease of $39 thousand from a year ago. Loan servicing expenses for the six months ended June 30, 2002 totaled $75 thousand, a decrease of $64 thousand or 46% from 2001. This decrease is attributable to the reduction in the principal balance of the Notes because servicing costs vary directly with these balances. Advisory fees for the six months ended June 30, 2002 were $27 thousand compared to $20 thousand a year ago, primarily attributable to increased securities processing costs in the current year. General and administrative expenses totaled $125 thousand, an increase of $18 thousand or 17% over the same

period in 2001, as a result of additional reporting and compliance costs.

On June 28, 2002, the Company paid a cash dividend of $0.46094 per share on outstanding preferred shares to the stockholders of record on June 15, 2002, as declared on June 4, 2002. On June 30, 2001, the Company paid a cash dividend of $0.46094 per share on outstanding preferred shares to the stockholders of

record on June 15, 2001, as declared on June 1, 2001. On a year-to-date basis, the Company declared and paid $9.2 million of dividends to holders of preferred shares for each of the six-month periods ended June 30, 2002 and 2001.

LIQUIDITY RISK MANAGEMENT

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

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

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

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

As presented in the accompanying Statements of Cash Flows, the primary sources of funds in addition to $52.6 million used by operations during the six months ended June 30, 2002 were $14.6 million provided by principal payments on the Notes and $409.5 million from the maturities and sales of securities available-for-sale. In the prior period ended June 30, 2001, the primary sources of funds other than $15.3 million from operations were $24.0 million provided by principal payments on the Notes and $190.1 million from the maturities and sales of securities available-for-sale. The primary uses of funds for the six months ended June 30, 2002 were $371.6 million for purchases of securities available-for-sale and $9.2 million in preferred stock dividends paid. For the prior year's six months ended June 30, 2001 the primary uses of funds were $213.6 million for purchases of securities available-for-sale and $9.2 million in preferred stock dividends paid.

MARKET RISK MANAGEMENT

The Company's market risk is composed primarily of interest rate risk. There have been no material changes in market risk or the manner in which the Company manages market risk since December 31, 2001.

OTHER MATTERS

As of June 30, 2002, the Company believes that it is in full compliance with the REIT tax rules, and expects to qualify as a REIT under the provisions of the Code. The Company expects to meet all REIT requirements regarding the ownership of its stock and anticipates meeting the annual distribution requirements.

FINANCIAL STATEMENTS OF HARRIS TRUST AND SAVINGS BANK

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

HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CONDITION
(UNAUDITED)

	JUNE 30 2002	DECEMBER 31 2001	JUNE 30 2001
	(IN THOUSANDS EXCEPT SHARE DATA)		
ASSETS			
Cash and demand balances due from banks	$ 918,094	$ 1,203,946	$ 1,040,2
Money market assets:			
Interest-bearing deposits at banks	405,582	195,723	182,4
Federal funds sold and securities purchased under agreement to resell	524,650	579,750	332,8
Trading account assets	35,211	90,562	62,9
Securities available-for-sale (including $2.67 billion, $3.21 billion, and $3.61 billion of securities pledged as collateral for repurchase agreements at June 30, 2002, December 31, 2001, and June 30, 2001 respectively)	4,902,417	5,822,229	6,486,5
Loans	9,482,692	9,972,473	10,485,8
Allowance for possible loan losses	(218,656)	(227,374)	(113,3
Net loans	9,264,036	9,745,099	10,372,4
Premises and equipment	287,620	287,549	285,6
Customers' liability on acceptances	16,924	13,365	31,4
Bank-owned insurance investments	973,982	952,225	928,3
Loans held for sale	61,245	121,588	119,8
Goodwill and other valuation intangibles	197,827	206,119	213,6
Other assets	590,932	518,016	484,7
TOTAL ASSETS	$18,178,520	$19,736,171	$20,541,0
LIABILITIES			
Deposits in domestic offices -- noninterest-bearing	$ 1,858,251	$ 3,170,649	$ 2,287,8
-- interest-bearing	8,106,859	6,311,796	6,969,1
Deposits in foreign office			

-- noninterest-bearing...	30,480	38,063	49,0
-- interest-bearing.....	1,074,501	1,670,352	2,628,0
Total deposits.....	11,070,091	11,190,860	11,934,1
Federal funds purchased and securities sold under agreement to repurchase.....	3,325,080	4,423,351	5,098,4
Short-term borrowings.....	557,198	704,699	152,7
Short-term senior notes.....	650,000	860,000	985,0
Acceptances outstanding.....	16,924	13,365	31,4
Accrued interest, taxes and other expenses.....	148,539	335,931	253,2
Other liabilities.....	391,080	167,288	58,2
Minority interest- preferred stock of subsidiary.....	255,000	255,000	250,0
Long-term notes -- subordinated.....	225,000	225,000	225,0
TOTAL LIABILITIES.....	16,638,912	18,175,494	18,988,2
STOCKHOLDER'S EQUITY			
Common stock ($10 par value); authorized 10,000,000 shares; issued and outstanding 10,000,000 shares....	100,000	100,000	100,0
Surplus.....	623,764	620,586	618,1
Retained earnings.....	787,922	819,991	842,5
Accumulated other comprehensive income (loss).....	27,922	20,100	(7,8
TOTAL STOCKHOLDER'S EQUITY.....	1,539,608	1,560,677	1,552,8
TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY.....	$18,178,520	$19,736,171	$20,541,0

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

HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

	QUARTER ENDED JUNE 30		SIX MONTHS JUNE 3
	2002	2001	2002
	(IN THOUSANDS EXCEPT SHARE DATA		
INTEREST INCOME			
Loans, including fees.....	$129,210	$195,189	$260,230
Money market assets:			
Deposits at banks.....	375	638	556
Federal funds sold and securities purchased under agreement to resell.....	2,989	3,466	4,807
Trading account.....	402	687	911
Securities available-for-sale:			
U.S. Treasury and Federal agency.....	47,289	92,264	105,611
State and municipal.....	5	24	18
Other.....	553	547	1,101
Total interest income.....	180,823	292,815	373,234

INTEREST EXPENSE			
Deposits	43,031	94,071	85,892
Short-term borrowings	14,112	62,198	31,760
Senior notes	3,944	9,234	10,022
Minority interest-dividends on preferred stock of subsidiary	4,609	4,609	9,219
Long-term notes	2,840	3,595	5,691
Total interest expense	68,536	173,707	142,584
NET INTEREST INCOME	112,287	119,108	230,650
Provision for loan losses	21,761	23,741	50,318
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	90,526	95,367	180,332
NONINTEREST INCOME			
Trust and investment management fees	22,773	22,809	42,364
Money market and bond trading	2,443	4,060	4,127
Foreign exchange	536	1,720	3,684
Service fees and charges	30,908	23,570	60,990
Securities gains	23,337	4,955	38,711
Bank-owned insurance investments	12,468	11,725	25,283
Foreign fees	5,828	5,259	11,853
Other	10,380	9,951	23,917
Total noninterest income	108,673	84,049	210,929
NONINTEREST EXPENSES			
Salaries and other compensation	74,387	75,000	151,152
Pension, profit sharing and other employee benefits	15,438	13,189	30,585
Net occupancy	10,240	9,793	19,583
Equipment	11,867	12,823	25,580
Marketing	7,344	8,571	14,682
Other	7,325	1,938	13,313
	126,601	121,314	254,895
Goodwill and other valuation intangibles	6,311	5,860	12,484
Total noninterest expenses	132,912	127,174	267,379
Income before income taxes	66,287	52,242	123,882
Applicable income taxes	20,089	12,452	35,656
NET INCOME	$ 46,198	$ 39,790	$ 88,226
EARNINGS PER COMMON SHARE (based on 10,000,000 average shares outstanding)			
Net Income	$ 4.62	$ 3.98	$ 8.82

The accompanying notes to the 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)

	2002	2001
	(IN THOUSANDS)	
BALANCE AT JANUARY 1	$1,560,677	$1,524,423
Net income	88,226	86,857
Contributions to capital	3,178	4,755
Dividends -- common stock	(120,000)	(66,000)
Dividends -- preferred stock	(295)	--
Other comprehensive income	7,822	2,814
BALANCE AT JUNE 30	$1,539,608	$1,552,849

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

HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)

	QUARTER ENDED JUNE 30		SIX MONTHS END JUNE 30	
	2002	2001	2002	2
	(IN THOUSANDS)			
Net income	$ 46,198	$ 39,790	$ 88,226	$ 8
Other comprehensive income:				
Cash flow hedges:				
Cumulative effect of accounting change	--	--	--	(
Net unrealized gain on derivative instruments, net of tax expense for the quarter of $3,432 in 2001 and net of tax expense for the year-to-date period of $4,621 in 2001	--	5,844	--	
Unrealized gains (losses) on available-for-sale securities:				
Unrealized holding gains (losses) arising during the period, net of tax expense (benefit) for the quarter of $28,978 in 2002 and ($12,584) in 2001 and net of tax expense for the year-to-date period of $20,218 in 2002 and $9,432 in 2001	44,428	(19,632)	31,475	1
Less reclassification adjustment for realized gains included in income statement, net of tax expense for the quarter of $9,078 in 2002 and $1,927 in 2001 and net of tax expense for the year-to-date period of $15,058 in 2002 and $6,970 in 2001	(14,259)	(3,028)	(23,653)	(1
Other comprehensive income (loss)	30,169	(16,816)	7,822	

Comprehensive income	$ 76,367	$ 22,974	$ 96,048	$ 8

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

HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	SIX MONTHS ENDED JUNE 30	
	2002	2001
	(IN THOUSANDS)	
OPERATING ACTIVITIES:		
Net income	$ 88,226	$ 86,857
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	50,318	38,199
Depreciation and amortization, including intangibles	33,457	33,816
Deferred tax expense (benefit)	4,271	(99)
Gain on sales of securities	(38,711)	(17,918)
Trading account net sales	55,351	2,233
Net decrease in interest receivable	18,253	44,117
Net decrease in interest payable	(5,549)	(12,817)
Net decrease in loans held for sale	60,343	122,436
Other, net	142,129	(22,496)
Net cash provided by operating activities	408,088	274,328
INVESTING ACTIVITIES:		
Net increase in interest-bearing deposits at banks	(209,859)	(41,125)
Net decrease in Federal funds sold and securities purchased under agreement to resell	55,100	158,250
Proceeds from sales of securities available-for-sale	2,071,179	961,230
Proceeds from maturities of securities available-for-sale	4,421,885	3,916,785
Purchases of securities available-for-sale	(5,521,560)	(4,841,081)
Net decrease in loans	430,744	239,115
Purchases of premises and equipment	(21,044)	(23,663)
Net increase in bank-owned insurance	(21,757)	(22,220)
Other, net	(202,087)	3,134
Net cash provided by investing activities	1,002,601	350,425
FINANCING ACTIVITIES:		
Net decrease in deposits	(120,769)	(559,244)
Net (decrease) increase in Federal funds purchased and securities sold under agreement to repurchase	(1,098,271)	489,531
Net decrease in short-term borrowings	(147,501)	(1,337,025)
Proceeds from issuance of senior notes	400,000	2,008,500
Repayment of senior notes	(610,000)	(1,413,000)

Cash dividends paid on common stock.....	(120,000)	(66,000)
Net cash used by financing activities.....	(1,696,541)	(877,238)
NET DECREASE IN CASH AND DEMAND BALANCES DUE FROM BANKS.....	(285,852)	(252,485)
CASH AND DEMAND BALANCES DUE FROM BANKS AT JANUARY 1...	1,203,946	1,292,694
CASH AND DEMAND BALANCES DUE FROM BANKS AT JUNE 30.....	$ 918,094	$ 1,040,209

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

HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

NOTES TO THE FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

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

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

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

2. LEGAL PROCEEDINGS

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

3. CASH FLOWS

For purposes of the Bank's Consolidated Statements of Cash Flows, cash and cash equivalents is defined to include cash and demand balances due from banks. Cash interest payments for the six months ended June 30 totaled $148.1 million and $396.6 million in 2002 and 2001, respectively. Cash income tax payments over the same periods totaled $17.7 million and $41.8 million, respectively.

4. GOODWILL AND OTHER INTANGIBLE

Assets The Bank adopted Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets," on January 1, 2002.

Under this standard, goodwill and other intangible assets that have indefinite useful lives are not subject to amortization while intangible assets with finite lives are amortized. The Bank has an unidentifiable intangible asset that is accounted for in accordance with SFAS No. 72, "Accounting for Certain Acquisitions of Banking or Thrift Institutions." This asset is excluded from the scope of SFAS No. 142 and continues to be amortized.

Upon adoption of the Statement and as of June 30, 2002, the Bank had no goodwill.

For the quarters and six months ended June 30, 2002 and June 30, 2001, the Bank had no goodwill amortization expense.

As of June 30, 2002, the gross carrying amount and accumulated amortization of the Bank's amortizable intangible assets were $337.9 million and $140.1 million, respectively.

Total amortization expense for the Bank's intangible assets was $6.3 million for the quarter ended June 30, 2002 and $12.5 million for the six months ended June 30, 2002.

Estimated intangible asset amortization expense for the years ending December 31, 2003, 2004, 2005, 2006 and 2007 is $25.1 million, $25.3 million, $25.5 million, $25.6 million and $25.8 million, respectively.

HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

FINANCIAL REVIEW

SECOND QUARTER 2002 COMPARED WITH SECOND QUARTER 2001

SUMMARY

The Bank had second quarter 2002 net income of $46.2 million, an increase of $6.4 million or 16 percent from second quarter 2001.

Cash ROE was 14.85 percent in the current quarter compared to 13.15 percent one year earlier.

Second quarter net interest income on a fully taxable equivalent basis was $114.6 million, down $8.9 million or 7 percent from $123.5 million in 2001's second quarter. Average earning assets decreased 15 percent to $15.18 billion from $17.88 billion in 2001, primarily attributable to a decrease of $1.0 billion in average loans and $2.1 billion in the investment portfolio, somewhat offset by an increase in money market assets of $233 million. Net interest margin rose from 2.78 percent in the year-ago quarter to 3.03 percent currently, reflecting the impact of the declining interest rate environment during 2001.

The second quarter provision for loan losses of $21.8 million was down $1.9 million from $23.7 million in the second quarter of 2001. Net charge-offs decreased to $22.8 million from $26.1 million in the prior year. Most of the decrease resulted from lower commercial loan write-offs.

Second quarter noninterest income of $108.7 million increased $24.6 million from the same quarter last year. Growth in noninterest income resulted from a $18.4 million increase in net gains from sales of investment securities and higher service charges on deposits amounting to $7.3 million.

Second quarter 2002 noninterest expenses of $132.9 million increased $5.7

million or 5 percent from the year ago quarter.

Nonperforming assets at June 30, 2002 were $181 million or 1.91 percent of total loans, down from $206 million or 2.10 percent at March 31, 2002, and $139 million or 1.32 percent a year ago. At June 30, 2002, the allowance for possible loan losses was $219 million, equal to 2.31 percent of loans outstanding, compared to $113 million or 1.08 percent at the end of second quarter 2001. As a result, the ratio of the allowance for possible loan losses to nonperforming assets increased from 82 percent at June 30, 2001 to 121 percent at June 30, 2002.

At June 30, 2002, Tier 1 capital of the Bank amounted to $1.58 billion, down from $1.60 billion one year earlier. The regulatory leverage capital ratio was 8.99 percent for the second quarter of 2002 compared to 7.77 percent in the same quarter of 2001. The Bank's June 30, 2002 Tier 1 and total risk-based capital ratios were 10.12 percent and 12.55 percent compared to respective ratios of 9.76 percent and 11.70 percent at June 30, 2001. The Bank's capital ratio exceeds the prescribed regulatory minimum for banks.

SIX MONTHS ENDED JUNE 30, 2002 COMPARED WITH 2001

SUMMARY

The Bank had net income for the six months ended June 30, 2002 of $88.2 million, an increase of $1.3 million or 2 percent from the same period a year ago.

Cash ROE was 14.06 percent in the current year, down slightly from 14.28 percent last year.

Net interest income on a fully taxable equivalent basis was $223.5 million, down $5.1 million or 2 percent from $240.6 million in 2001's year-to-date period. Average earning assets decreased 13 percent to $15.57 billion from $17.90 billion in 2001, primarily attributable to a $828 million decrease in average loans and $1.7 billion decrease in the investment portfolio, which was somewhat offset by an increase of $229 million in money market assets. Net interest margin rose from 2.75 percent in 2001 to 3.04 percent currently, primarily reflecting the impact of the declining interest rate environment in 2001.

The year-to-date 2002 provision for loan losses of $50.3 million was up $12.1 million from $38.5 million in 2001. Net charge-offs were $59.0 million, an increase of $15.3 million from last year, primarily reflecting an increase in commercial loan write-offs.

Noninterest income of $210.9 million increased $31.5 million from the same period last year. Most of this increase resulted from additional net gains from securities sales of $20.8 million and higher service charges on deposits amounting to $15.3 million.

Noninterest expenses of $267.4 million increased $10.4 million or 4 percent from the year ago period. Income tax expense increased $7.0 million, reflecting higher pretax income.

PART II. OTHER INFORMATION

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

ITEM 6. (a) REPORTS ON FORM 8-K: NONE

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, Harris Preferred Capital Corporation has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized on the 14th day of August 2002.

/s/ PAUL R. SKUBIC

Paul R. Skubic
Chairman of the Board and President

/s/ PAMELA PIAROWSKI

Pamela C. Piarowski
Chief Financial Officer