HARRIS PREFERRED CAPITAL CORP
Form 10-Q
November 13, 2003

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2003

COMMISSION FILE NUMBER 1-13805

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

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

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).
Yes [ ]   No [X]

The number of shares of Common Stock, $1.00 par value, outstanding on November 13, 2003 was 1,000.

HARRIS PREFERRED CAPITAL CORPORATION

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HARRIS PREFERRED CAPITAL CORPORATION

BALANCE SHEETS

	SEPTEMBER 30, 2003	DECEMBER 31, 2002	SEPTEMBER 2002
	(UNAUDITED)	(AUDITED)	(UNAUDIT
	(IN THOUSANDS, EXCEPT SHARE DATA)		
ASSETS			
Cash on deposit with Harris Trust and Savings Bank.....	$ 141	$ 728	$ 50
Securities purchased from Harris Trust and Savings Bank under agreement to resell..........................	13,000	20,000	17,50
Notes receivable from Harris Trust and Savings Bank....	18,753	31,078	36,74
Securities available-for-sale:			
Mortgage-backed..................................	289,566	365,383	273,33
U.S. Treasury....................................	175,000	79,976	219,91
Securing mortgage collections due from Harris Trust and Savings Bank.......................................	1,135	2,930	2,27
Other assets...	1,143	1,947	1,18
TOTAL ASSETS..................................	$498,738	$502,042	$551,46
LIABILITIES AND STOCKHOLDERS' EQUITY			

Broker payable -- due to securities purchase..........	$ --	$ --	$ 50,39
Accrued expenses......................................	20	96	2
TOTAL LIABILITIES..................................	20	96	50,41
Commitments and contingencies.........................	--	--	-
STOCKHOLDERS' EQUITY			
7 3/8% Noncumulative Exchangeable Preferred Stock, Series A ($1 par value); liquidation value of $25.00 per share; 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 distributions...................	3,261	850	3,88
Accumulated other comprehensive income -- unrealized gains on available-for-sale securities..............	4,723	10,362	6,42
TOTAL STOCKHOLDERS' EQUITY........................	498,718	501,946	501,04
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY........	$498,738	$502,042	$551,46

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

HARRIS PREFERRED CAPITAL CORPORATION

STATEMENTS OF OPERATIONS
AND COMPREHENSIVE INCOME
(UNAUDITED)

	QUARTER ENDED SEPTEMBER 30		NINE MONTHS ENDED SEPTEMBER 30	
	2003	2002	2003	2002
	(IN THOUSANDS, EXCEPT PER SHARE DATA)			
INTEREST INCOME:				
Securities purchased from Harris Trust and Savings Bank under agreement to resell.......	$ 307	$ 676	$ 850	$ 1,635
Notes receivable from Harris Trust and Savings Bank..	341	641	1,226	2,226
Securities available-for-sale:				
Mortgage-backed............................	3,178	3,028	11,754	10,945
U.S. Treasury..............................	30	114	99	284
Total interest income....................	3,856	4,459	13,929	15,090
NON-INTEREST INCOME:				
Gain (loss) on sale of securities..............	687	(17)	3,149	2,678
OPERATING EXPENSES:				
Loan servicing fees paid to Harris Trust and Savings Bank...............................	16	31	57	106
Advisory fees paid to Harris Trust and Savings Bank..	10	8	30	35
General and administrative.....................	54	47	222	172

Total operating expenses	80	86	309	313
Net income	4,463	4,356	16,769	17,455
Preferred dividends	4,609	4,609	13,828	13,828
NET (DEFICIT) INCOME AVAILABLE TO COMMON STOCKHOLDER	$ (146)	$ (253)	$ 2,941	$ 3,627
Basic and diluted (losses) earnings per common share	$(146.00)	$(253.00)	$2,941.00	$3,627.00
Net income	$ 4,463	$ 4,356	$ 16,769	$ 17,455
Other comprehensive (loss) income -- unrealized gains (losses) on available-for-sale securities	(3,529)	4,615	(5,639)	8,305
Comprehensive income	$ 934	$ 8,971	$ 11,130	$ 25,760

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

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HARRIS PREFERRED CAPITAL CORPORATION

STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(UNAUDITED)

	NINE MONTHS ENDED SEPTEMBER 30	
	2003	2002
	(IN THOUSANDS, EXCEPT PER SHARE DATA)	
Balance at January 1	$501,946	$489,242
Net income	16,769	17,455
Other comprehensive (loss) income	(5,639)	8,305
Dividends -- common stock	(530)	(130)
Dividends (preferred stock $0.4609 per share)	(13,828)	(13,828)
Balance at September 30	$498,718	$501,044

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

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HARRIS PREFERRED CAPITAL CORPORATION

STATEMENTS OF CASH FLOWS
(UNAUDITED)

	NINE MONTHS ENDED SEPTEMBER 30 2003	NINE MONTHS ENDED SEPTEMBER 30 2002
	(IN THOUSANDS)	
OPERATING ACTIVITIES:		
Net Income	$ 16,769	$ 17,455
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sale of securities	(3,149)	(2,678)
Net decrease in other assets	804	756
Net decrease in accrued expenses	(76)	(80)
Net cash provided by operating activities	14,348	15,453
INVESTING ACTIVITIES:		
Net decrease in securities purchased from Harris Trust and Savings Bank under agreement to resell	7,000	3,500
Repayments of notes receivable from Harris Trust and Savings Bank	12,325	19,213
Decrease in securing mortgage collections due from Harris Trust and Savings Bank	1,795	3,083
Purchases of securities available-for-sale	(535,416)	(616,678)
Proceeds from maturities and sales of securities available-for-sale	513,719	589,382
Net cash used in investing activities	(577)	(1,500)
FINANCING ACTIVITIES:		
Cash dividends paid on preferred stock	(13,828)	(13,828)
Cash dividends paid on common stock	(530)	(130)
Net cash used by financing activities	(14,358)	(13,958)
Net decrease in cash on deposit with Harris Trust and Savings Bank	(587)	(5)
Cash on deposit with Harris Trust and Savings Bank at beginning of period	728	506
Cash on deposit with Harris Trust and Savings Bank at end of period	$ 141	$ 501
NON CASH TRANSACTION		
Unsettled security purchase	$ --	$ 50,397

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 Bank is an indirect wholly-owned U.S. subsidiary of Bank of Montreal.

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 2002 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.

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

THIRD QUARTER 2003 COMPARED WITH THIRD QUARTER 2002

The Company's net income for the third quarter of 2003 was $4.5 million. This represented a $107 thousand or 2% increase from third quarter 2002 earnings of $4.4 million. Earnings increased primarily because of a $687 thousand gain on sale of securities in third quarter 2003 compared to a $17 thousand loss in the third quarter of 2002.

HARRIS PREFERRED CAPITAL CORPORATION

Third quarter 2003 interest income on the Notes totaled $341 thousand and yielded 6.4% on $21 million of average principal outstanding for the quarter compared to $641 thousand and a 6.4% yield on $40 million average principal outstanding for third quarter 2002. The decrease in income was attributable to a reduction in the Note balance because of principal paydowns by customers in the underlying Securing Mortgage Loans. The average outstanding balance of the Securing Mortgage Loans for third quarter 2003 and 2002 was $26 million and $49 million, respectively. Interest income on securities available-for-sale for the current quarter was $3.2 million resulting in a yield of 4.1% on an average balance of $316 million, compared to $3.1 million with a yield of 4.6% on an average balance of $276 million for the same period a year ago. The increase in interest income from available-for-sale is primarily attributable to the increase in the investment portfolio and partially offset by the reduction in yield. As securities mature or are sold, proceeds have been invested in lower yielding securities because market interest rates have generally been declining.

There were no Company borrowings during third quarter 2003 or 2002.

Third quarter 2003 operating expenses totaled $80 thousand, a decrease of $6 thousand or 7% from the third quarter of 2002. Loan servicing expenses totaled $16 thousand, a decrease of $15 thousand or 48% 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 third quarter 2003 were $10 thousand compared to $8 thousand a year earlier due to increased securities processing costs in the third quarter of 2003. General and administrative expenses totaled $54 thousand, an increase of $7 thousand or 15% over the same period in 2002, as a result of additional corporate governance costs.

At September 30, 2003 and 2002, 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.

In the current quarter, the Company had a $146,000 loss after dividends on its preferred stock compared to a $253,000 loss in the third quarter of 2002. The Company anticipates that it has sufficient liquidity and earnings capacity to continue preferred dividend payments on an uninterrupted basis.

NINE MONTHS ENDED SEPTEMBER 30, 2003 COMPARED WITH SEPTEMBER 30, 2002

The Company's net income for the nine months ended September 30, 2003 was $16.8 million. This represented a $686 thousand or 4% decrease from 2002 earnings of $17.5 million. Earnings declined 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.

Interest income on securities purchased under agreement to resell for the nine months ended September 30, 2003 was $850 thousand, a decrease of $785 thousand from the same period in 2002. Interest income on the Notes for the nine months ended September 30, 2003 totaled $1.2 million and yielded 6.4% on $26 million of average principal outstanding compared to $2.2 million of income yielding 6.4% on $46 million of average principal outstanding for the same period in 2002. The decrease in income was attributable to a reduction in the Note balance because of customer payoffs on the Securing Mortgage Loans.

Interest income on securities available-for-sale for the nine months ended September 30, 2003 was $11.9 million resulting in a yield of 4.6% on an average balance of $346 million, compared to $11.2 million of income with a yield of 5.3 on an average balance of $285 million a year ago. The increase in interest income from securities available-for-sale is primarily attributable to the increase in the investment portfolio and partially offset by the reduction in yield. As securities mature or are sold, proceeds have been invested in lower yielding securities as a result of declining market interest rates. Gains from investment securities sales for the nine months ended September 30, 2003 were $3.1 million compared to $2.7 million a year ago. The average outstanding balance of the Securing Mortgage Loans was $31 million for the nine months ended September 30, 2003 and $40 million for the same period in 2002. There were no Company borrowings during either period.

Operating expenses for the nine months ended September 30, 2003 totaled $309 thousand, a decrease of $4 thousand from a year ago. Loan servicing expenses for the nine months ended September 30, 2003 totaled $57 thousand, a decrease of $49 thousand or 46% from 2002. This decrease is attributable to the reduction in the principal balance of the Notes because servicing costs vary directly with these balances. Advisory fees for the nine months ended September 30, 2003 were $30 thousand compared to $35 thousand a year ago; primarily attributable to increased securities processing costs in 2002. General and administrative expenses totaled $222 thousand, an increase of $50 thousand or 29% over the same period in 2002, as a result of additional insurance and corporate governance costs.

On September 30, 2003, the Company paid a cash dividend of $0.46094 per share on outstanding preferred shares to the stockholders of record on September 15, 2003, as declared on September 3, 2003. On September 12, 2003, the Company paid a cash dividend of $530 thousand on the outstanding common shares to the stockholder of record on September 3, 2003, as declared on September 3, 2003. This latter dividend completed the 2002 REIT tax compliance requirements. On September 30, 2002, the Company paid a cash dividend of $0.46094 per share on outstanding preferred shares to the stockholders of record on September 15, 2002, as declared on September 6, 2002. On September 12, 2002, the Company paid a cash dividend of $130 thousand on the outstanding common shares to the stockholder of record on September 4, 2002, as declared on September 4, 2002. This latter dividend completed the 2001 REIT tax compliance requirements. On a year-to-date basis, the Company declared and paid $13.8 million of dividends to holders of preferred shares for each of the nine-month periods ended September 30, 2003 and 2002.

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 $14.3 million provided from operations during the nine months ended September 30, 2003 were $12.3 million provided by principal repayments on the Notes and $513.7 million from the maturities and sales of securities available-for-sale. In the prior period ended September 30, 2002, the primary sources of funds other than $15.5 million from operations were $19.2 million provided by principal repayments on the Notes and $589.4 million from the maturities and sales of securities available-for-sale. The primary uses of funds for the nine months ended September 30, 2003 were $535.4 million for purchases of securities available-for-sale and $13.8 million in preferred stock dividends paid. For the prior year's quarter ended September 30, 2002, the

primary uses of funds were $616.7 million for purchases of securities available-for-sale and $13.8 million in preferred stock dividends paid.

MARKET RISK MANAGEMENT

The Company's market risk is composed primarily of interest rate risk. There have been no material changes in market risk or the manner in which the Company manages market risk since December 31, 2002.

OTHER MATTERS

As of September 30, 2003, 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

	SEPTEMBER 30 2003	DECEMBER 31 2002
	(UNAUDITED)	(AUDITED)
	(IN THOUSANDS EXCEPT SHARE	
ASSETS		
Cash and demand balances due from banks	$ 931,360	$ 1,057,254
Money market assets:		
Interest-bearing deposits at banks	394,428	417,206
Federal funds sold and securities purchased under agreement to resell	724,345	237,950
Trading account assets	26,066	42,423
Securities available-for-sale (including $4.17 billion, $4.39 billion, and $4.12 billion of securities pledged as collateral for repurchase agreements at September 30, 2003, December 31, 2002, and September 30, 2002, respectively)	6,673,499	5,781,360
Loans	9,397,975	9,607,887
Allowance for possible loan losses	(226,940)	(206,999)
Net loans	9,171,035	9,400,888
Premises and equipment	303,066	298,414
Customers' liability on acceptances	32,632	16,168
Bank-owned insurance investments	1,024,783	994,185
Loans held for sale	176,162	149,311
Goodwill and other valuation intangibles	183,443	187,317
Other assets	530,093	444,542
TOTAL ASSETS	$20,170,912	$19,027,018
LIABILITIES		
Deposits in domestic offices -- noninterest-bearing	$ 4,316,409	$ 3,414,159
-- interest-bearing	7,492,481	6,408,171
Deposits in foreign offices -- noninterest-bearing	23,729	31,383
-- interest-bearing	1,063,120	1,184,571
Total deposits	12,895,739	11,038,284
Federal funds purchased and securities sold under agreement to repurchase	4,713,078	5,060,784
Short-term borrowings	1,926	300,694
Short-term senior notes	--	200,000
Acceptances outstanding	32,632	16,168
Accrued interest, taxes and other expenses	140,820	153,148
Other liabilities	312,079	200,286
Minority interest- preferred stock of subsidiary	250,000	250,000
Preferred stock issued to Harris Bankcorp, Inc.	5,000	5,000
Long-term notes -- subordinated	225,000	225,000
TOTAL LIABILITIES	18,576,274	17,449,364
STOCKHOLDER'S EQUITY		
Common stock ($10 par value); authorized 10,000,000 shares; issued and outstanding 10,000,000 shares	100,000	100,000
Surplus	633,355	626,640
Retained earnings	836,481	803,249
Accumulated other comprehensive income	24,802	47,765
TOTAL STOCKHOLDER'S EQUITY	1,594,638	1,577,654
TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY	$20,170,912	$19,027,018

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 SEPTEMBER 30		NINE MONTHS SEPTEMBER	
	2003	2002	2003	
	(IN THOUSANDS EXCEPT SHARE DATA			
INTEREST INCOME				
Loans, including fees..	$114,101	$128,809	$353,340	$3
Money market assets:				
Deposits at banks..	583	694	2,339	
Federal funds sold and securities purchased under agreement to resell..................................	891	1,673	2,586	
Trading account..	443	487	1,300	
Securities available-for-sale:				
U.S. Treasury and Federal agency..........................	40,732	45,382	126,207	1
State and municipal.....................................	27	3	39	
Other...	347	554	1,816	
Total interest income................................	157,124	177,602	487,627	5
INTEREST EXPENSE				
Deposits...	31,138	41,063	89,984	1
Short-term borrowings......................................	10,746	15,862	40,300	
Senior notes...	971	1,528	3,569	
Minority interest-dividends on preferred stock of subsidiary...	4,609	4,609	13,828	
Long-term notes..	2,585	2,831	7,872	
Total interest expense...............................	50,049	65,893	155,553	2
NET INTEREST INCOME..	107,075	111,709	332,074	3
Provision for loan losses..................................	28,732	8,075	76,632	
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES.........	78,343	103,634	255,442	2
NONINTEREST INCOME				
Trust and investment management fees.......................	21,729	20,527	62,071	
Money market and bond trading..............................	957	4,133	7,717	
Foreign exchange...	1,350	(69)	3,576	
Service fees and charges...................................	27,576	29,213	84,482	
Securities gains...	1,224	22,562	9,543	
Bank-owned insurance investments...........................	11,659	13,693	33,228	
Foreign fees...	6,528	6,307	18,966	
Other..	56,319	40,721	155,141	1
Total noninterest income.............................	127,342	137,087	374,724	3

NONINTEREST EXPENSES				
Salaries and other compensation............................	88,764	84,077	241,826	2
Pension, profit sharing and other employee benefits.........	21,199	15,413	58,261	
Net occupancy...	11,279	11,477	31,847	
Equipment...	13,948	13,546	41,140	
Marketing...	8,196	7,024	22,929	
Communication and delivery..................................	6,262	5,532	17,287	
Expert services...	6,961	8,495	20,356	
Contract programming..	8,761	7,816	21,527	
Other...	13,150	12,377	51,963	
	178,520	165,757	507,136	4
Amortization of valuation intangibles......................	4,682	4,049	13,197	
Total noninterest expenses..........................	183,202	169,806	520,333	4
Income before income taxes..................................	22,483	70,915	109,833	1
Applicable income taxes.....................................	2,853	20,803	26,263	
NET INCOME..	$ 19,630	$ 50,112	$ 83,570	$1
EARNINGS PER COMMON SHARE (based on 10,000,000 average shares outstanding)				
Net Income..	$ 1.96	$ 5.01	$ 8.36	$

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 SEPTEMBER 30		NINE MONTHS END SEPTEMBER 30	
	2003	2002	2003	200
	(IN THOUSANDS)			
NET INCOME..	$ 19,630	$50,112	$83,570	$141,
OTHER COMPREHENSIVE INCOME:				
Unrealized gains on available-for-sale securities:				
Unrealized holding (losses) gains arising during the period, net of tax (benefit) expense for the quarter of ($19,976) in 2003 and $35,177 in 2002 and net of tax (benefit) expense for the year-to-date period of ($11,831) in 2003 and $55,395 in 2002..............................	(29,722)	53,809	(17,132)	85,
Less reclassification adjustment for realized gains included in income statement, net of tax expense for the quarter of $476 in 2003 and $8,777 in 2002 and net of tax expense for the year-to-date period of $3,712 in 2003 and $23,835 in 2002..............................	(749)	(13,785)	(5,831)	(37,

Other comprehensive income	(30,471)	40,024	(22,963)	47,
COMPREHENSIVE (LOSS) INCOME	$(10,841)	$90,136	$60,607	$189,

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

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HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

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

	2003	2002
	(IN THOUSANDS)	
BALANCE AT JANUARY 1	$1,577,654	$1,560,677
Net income	83,570	141,282
Contributions to capital	6,715	4,626
Dividends -- common stock	(50,000)	(170,000)
Dividends -- preferred stock	(338)	(438)
Other comprehensive (loss) income	(22,963)	47,845
BALANCE AT SEPTEMBER 30	$1,594,638	$1,583,992

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

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HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	NINE MONTHS ENDED SEPTEMBER 30	
	2003	2002
	(IN THOUSANDS)	
OPERATING ACTIVITIES:		
Net income	$ 83,570	$ 141,282
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	76,632	58,393
Depreciation and amortization, including intangibles	50,123	45,254
Deferred tax (benefit) expense	(2,940)	3,343

Gain on sales of securities	(9,543)	(61,273)
Increase in bank-owned insurance	(32,598)	(35,372)
Trading account net sales (purchases)	43,801	(82,870)
Net (increase) decrease in interest receivable	(757)	15,119
Net increase (decrease) in interest payable	3,462	(1,377)
Net (increase) decrease in loans held for sale	(26,851)	14,500
Other, net	40,079	83,089
Net cash provided by operating activities	224,978	180,088
INVESTING ACTIVITIES:		
Net decrease (increase) in interest-bearing deposits at banks	22,778	(207,071)
Net increase in Federal funds sold and securities purchased under agreement to resell	(486,395)	(832,400)
Proceeds from sales of securities available-for-sale	827,198	2,653,662
Proceeds from maturities of securities available-for-sale	3,756,918	5,901,150
Purchases of securities available-for-sale	(5,526,178)	(8,535,186)
Net decrease in loans	136,148	444,898
Purchases of premises and equipment	(41,578)	(37,374)
Other, net	(744)	--
Net cash used by investing activities	(1,311,853)	(612,321)
FINANCING ACTIVITIES:		
Net increase in deposits	1,857,455	843,628
Net (decrease) increase in Federal funds purchased and securities sold under agreement to repurchase	(347,706)	422,166
Net decrease in short-term borrowings	(298,768)	(109,287)
Proceeds from issuance of senior notes	2,425,000	400,000
Repayment of senior notes	(2,625,000)	(1,160,000)
Cash dividends paid on common stock	(50,000)	(170,000)
Net cash provided by financing activities	960,981	226,507
NET DECREASE IN CASH AND DEMAND BALANCES DUE FROM BANKS	(125,894)	(205,726)
CASH AND DEMAND BALANCES DUE FROM BANKS AT JANUARY 1	1,057,254	1,203,946
CASH AND DEMAND BALANCES DUE FROM BANKS AT SEPTEMBER 30	$ 931,360	$ 998,220

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

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HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

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 nine months ended September 30 totaled $152.1 million and $209.9 million in 2003 and 2002, respectively. Cash income tax payments over the same periods totaled $7.7 million and $25.3 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. Goodwill is periodically assessed for impairment, at least annually. Upon adoption of SFAS No. 142, the Bank had no goodwill.

The Bank adopted SFAS No. 147, "Acquisitions of Certain Financial Institutions -- an amendment of FASB Statements No. 72 and 144 and FASB Interpretation No. 9," on October 1, 2002. Under this standard, most acquisitions of financial institutions are removed from the scope of SFAS No. 72 and Interpretation No. 9 and are accounted for in accordance with SFAS No. 141, "Business Combinations," and SFAS No. 142. As such, unidentifiable intangible assets recognized and amortized in accordance with SFAS No. 72, "Accounting for Certain Acquisitions of Banking or Thrift Institutions," represent goodwill that will be accounted for under SFAS No. 142. At adoption date, the Bank had an unidentifiable intangible asset that, in accordance with SFAS No. 72, was excluded from the scope of SFAS No. 142 and continued to be amortized through third quarter 2002. Upon adoption of the Statement, the unidentifiable intangible asset was reclassified to goodwill and no longer amortized starting in fourth quarter 2002. Under the transitional requirements of the Statement, the first three quarters of 2002 were restated to reflect the reversal of previously amortized goodwill in those quarters. The earnings impact for each of these three quarters was $2.35 million pretax ($1.4 million after tax).

The Bank's goodwill was subject to the annual impairment test in the fourth quarter of 2002. The fair value of the reporting unit was estimated using a valuation technique based on multiples of book value. The test did not identify potential impairment and no impairment loss was recognized in 2002.

The carrying value of the Bank's goodwill as of September 30, 2003 was $89.3 million.

As of September 30, 2003, the gross carrying amount and accumulated amortization of the Bank's amortizable intangible assets were $213.7 million and $119.6 million, respectively.

Total amortization expense for the Bank's intangible assets was $4.7 million for the quarter ended September 30, 2003.

Estimated intangible asset amortization expense for the years ending December 31, 2004, 2005, 2006, 2007 and 2008 is $18.0 million, $18.2 million, $18.4 million, $18.7 million and $18.9 million, respectively.

HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

FINANCIAL REVIEW

THIRD QUARTER 2003 COMPARED WITH THIRD QUARTER 2002

SUMMARY

The Bank had third quarter 2003 net income of $19.6 million, a decrease of $30.5 million or 61 percent from third quarter 2002.

Cash ROE was 6.26 percent in the current quarter and 15.54 percent in the third quarter 2002. Excluding the impact of unrealized gains and losses in the securities portfolio recorded directly to equity, cash ROE was 6.46 percent in the current quarter, compared to 16.06 percent a year ago.

Third quarter net interest income on a fully taxable equivalent basis was $109.7 million, down $4.8 million or 4 percent from $114.5 million in 2002's third quarter. Average earning assets increased 10 percent to $16.79 billion from $15.28 billion in 2002, primarily due to an increase of $1.21 billion in average securities available for sale. Net interest margin decreased to 2.60 percent in the current quarter from 2.98 percent in the year-ago quarter, reflecting the impact of declining spreads, particularly in the securities portfolio.

The third quarter provision for loan losses of $28.7 million was up $20.6 million from $8.1 million in the third quarter of 2002. Net charge-offs were $17.6 million in both the current quarter and the third quarter 2002.

Third quarter noninterest income of $127.3 million decreased $9.7 million from the same quarter last year. The decrease was primarily due to a $21.3 million decrease in net gains from sales of investment securities offset by a $5.2 million increase in gains on sales of mortgage loans and a $3.6 million increase in syndication fees.

Third quarter 2003 noninterest expenses of $183.2 million increased $13.4 million or 8 percent from the year ago quarter. Employment related expenses accounted for $10.5 million of the increase.

Nonperforming assets at September 30, 2003 were $182 million or 1.94 percent of total loans, down from $202 million or 2.06 percent at September 30, 2003, and $171 million or 1.82 percent a year ago. At September 30, 2003, the allowance for possible loan losses was $227 million, equal to 2.41 percent of loans outstanding, compared to $209 million or 2.22 percent at the end of third quarter 2002. As a result, the ratio of the allowance for possible loan losses to nonperforming assets increased from 122 percent at September 30, 2002 to 124 percent at September 30, 2003.

At September 30, 2003, Tier 1 capital of the Bank amounted to $1.62 billion, up from $1.58 billion one year earlier. The regulatory leverage capital ratio was 8.42 percent for the third quarter of 2003 compared to 8.98 percent in the same quarter of 2002. The Bank's capital ratio exceeds the prescribed regulatory minimum for banks. The Bank's September 30, 2003 Tier 1 and total risk-based capital ratios were 10.09 percent and 12.28 percent compared to respective ratios of 10.06 percent and 12.49 percent at September 30, 2002.

The Bank had net income for the nine months ended September 30, 2003 of $83.6 million, a decrease of $57.7 million or 41 percent from the same period a year ago.

Excluding the impact of unrealized gains and losses in the securities portfolio, cash ROE was 9.07 percent, down from 11.13 percent last year.

Net interest income on a fully taxable equivalent basis was $340.7 million, down $9.3 million or 3 percent from $350.0 million in 2002's year-to-date period. Average earning assets increased 4 percent to $16.51 billion from $15.47 billion in 2002, primarily attributable to a $1.05 billion increase in average securities available for sale. Net interest margin decreased to 2.76 percent from 3.02 percent in 2002, reflecting the impact of declining spreads, particularly in the securities portfolio.

The year-to-date 2003 provision for loan losses of $76.6 million was up $18.2 million from $58.4 million in 2002. Net charge-offs were $56.7 million, a decrease of $19.9 million from last year, resulting from lower commercial loan write-offs.

Noninterest income of $374.7 million decreased $24.7 million from the same period last year. Net gains from securities sales decreased $51.7 million while gains on sales of mortgage loans increased $9.2 million and syndication fees increased $5.7 million.

Noninterest expenses of $520.3 million increased $36.4 million or 8 percent from the year ago period. Income tax expense decreased $32.0 million, reflecting lower pretax income.

ITEM 4. CONTROLS AND PROCEDURES

We are responsible for establishing and maintaining a set of disclosure controls and procedures ("DCP") that are designed to ensure that information required to be disclosed by us in the reports filed by us under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. In addition, we are responsible for establishing and maintaining adequate internal control over our financial reporting ("IC") that is designed to provide reasonable assurances that our records are maintained in reasonable detail to accurately and fairly reflect transactions, our transactions are properly authorized, our assets are safeguarded against unauthorized or improper acquisition, use or disposition, and our transactions are properly recorded and reported to permit the preparation of our financial statements in conformity with generally accepted accounting principles. As of the end of the third quarter of 2003, we conducted an evaluation of the effectiveness of the design and operations of our DCP pursuant to Rule 13a-15 of the Exchange Act. Based on that evaluation our Chairman of the Board and President and Chief Financial Officer concluded that our DCP are effective.

There were no changes in our IC during our third quarter of 2003 that materially affected or are reasonably likely to materially affect our IC, including any corrective actions with regard to significant deficiencies and material weaknesses.

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) 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

(b) 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 13th day of November 2003.

/s/ PAUL R. SKUBIC

Paul R. Skubic
Chairman of the Board and President

/s/ JANINE MULHALL

Janine Mulhall
Chief Financial Officer