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HARRIS PREFERRED CAPITAL CORP

Form 10-Q

May 14, 2004

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, 2004

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 No

Indicate by check mark whether the registrant is an accelerated filer (as

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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 13, 2004 was 1,000.

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, 2004	DECEMBER 31, 2003	MARCH 2003
	-----	-----	-----
	(UNAUDITED)	(AUDITED)	(UNAUDITED)
	(IN THOUSANDS, EXCEPT SHARE DATA)		
ASSETS			
Cash on deposit with Harris Trust and Savings Bank.....	\$ 562	\$ 926	\$
Securities purchased from Harris Trust and Savings Bank under agreement to resell.....	15,000	11,500	22,
Notes receivable from Harris Trust and Savings Bank.....	15,184	16,547	27,
Securities available-for-sale:			

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Mortgage-backed.....	212,427	233,857	325,
U.S. Treasury.....	249,434	229,995	149,
Securing mortgage collections due from Harris Trust and Savings Bank.....	603	414	
Other assets.....	962	1,079	1,
	-----	-----	-----
TOTAL ASSETS.....	\$494,172	\$494,318	\$527,
	=====	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY			
Broker payable -- due to securities purchase.....	\$ --	\$ --	\$ 25,
Accrued expenses.....	97	84	
	-----	-----	-----
TOTAL LIABILITIES.....	97	84	25,
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,
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.....	265	1,230	3,
Accumulated other comprehensive income -- net unrealized gains/(losses) on available-for-sale securities.....	3,076	2,270	8,
	-----	-----	-----
TOTAL STOCKHOLDERS' EQUITY.....	494,075	494,234	502,
	-----	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY.....	\$494,172	\$494,318	\$527,
	=====	=====	=====

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

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HARRIS PREFERRED CAPITAL CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
AND COMPREHENSIVE INCOME
(UNAUDITED)

	QUARTER ENDED MARCH 31	
	2004	2003
	-----	-----
	(IN THOUSANDS, EXCEPT PER SHARE DATA)	
INTEREST INCOME:		
Securities purchased from Harris Trust and Savings Bank under agreement to resell.....	\$ 471	\$ 247
Notes receivable from Harris Trust and Savings Bank.....	258	472
Securities available-for-sale:		
Mortgage-backed.....	2,630	4,526
U.S. Treasury.....	24	48
	-----	-----
Total interest income.....	3,383	5,293
NON-INTEREST INCOME:		

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Gain on sale of securities.....	398	2,463
	-----	-----
OPERATING EXPENSES:		
Loan servicing fees paid to Harris Trust and Savings		
Bank.....	12	22
Advisory fees paid to Harris Trust and Savings Bank.....	29	10
General and administrative.....	96	98
	-----	-----
Total operating expenses.....	137	130
	-----	-----
Net income.....	3,644	7,626
Preferred dividends.....	4,609	4,609
	-----	-----
NET INCOME (LOSS) AVAILABLE TO COMMON STOCKHOLDER.....	\$ (965)	\$ 3,017
	=====	=====
Basic and diluted earnings (loss) per common share.....	\$ (965.00)	\$3,017.00
	=====	=====
Net income.....	\$ 3,644	\$ 7,626
Other comprehensive income (loss) -- net unrealized		
gains/(losses) on available-for-sale securities.....	806	(2,233)
	-----	-----
Comprehensive income.....	\$ 4,450	\$ 5,393
	=====	=====

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

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HARRIS PREFERRED CAPITAL CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(UNAUDITED)

	QUARTER ENDED MARCH 31	
	2004	2003
	-----	-----
	(IN THOUSANDS, EXCEPT PER SHARE DATA)	
Balance at January 1.....	\$494,234	\$501,946
Net income.....	3,644	7,626
Other comprehensive income (loss).....	806	(2,233)
Dividends (preferred stock \$0.4609 per share).....	(4,609)	(4,609)
	-----	-----
Balance at March 31.....	\$494,075	\$502,730
	=====	=====

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

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HARRIS PREFERRED CAPITAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

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	QUARTER ENDED MARCH 31	
	2004	2003
	(IN THOUSANDS)	
OPERATING ACTIVITIES:		
Net Income.....	\$ 3,644	\$ 7,626
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sale of securities.....	(398)	(2,463)
Net decrease in other assets.....	117	360
Increase (decrease) in accrued expenses.....	13	(13)
	-----	-----
Net cash provided by operating activities.....	3,376	5,510
	-----	-----
INVESTING ACTIVITIES:		
Net decrease in securities purchased from Harris Trust and Savings Bank under agreement to resell.....	(3,500)	(2,000)
Repayments of notes receivable from Harris Trust and Savings Bank.....	1,363	3,848
(Increase) decrease in securing mortgage collections due from Harris Trust and Savings Bank.....	(189)	1,939
Purchases of securities available-for-sale.....	(250,000)	(149,929)
Proceeds from maturities and sales of securities available-for-sale.....	253,195	144,759
	-----	-----
Net cash provided (used) in investing activities.....	869	(1,383)
	-----	-----
FINANCING ACTIVITIES:		
Cash dividends paid on preferred stock.....	(4,609)	(4,609)
	-----	-----
Net decrease in cash on deposit with Harris Trust and Savings Bank.....	(364)	(482)
Cash on deposit with Harris Trust and Savings Bank at beginning of period.....	926	728
	-----	-----
Cash on deposit with Harris Trust and Savings Bank at end of period.....	\$ 562	\$ 246
	=====	=====
NON CASH TRANSACTION		
Unsettled security purchase.....	\$ --	\$ 25,066
	=====	=====

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

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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., a wholly-owned subsidiary of the Bank, owns 100% of the Company's common stock.

The accompanying consolidated financial statements have been prepared by management from the books and records of the Company. These statements reflect all adjustments and disclosures which are, in the opinion of management, necessary for a fair statement of the results for the interim periods presented and should be read in conjunction with the notes to financial statements included in the Company's 2003 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 2004 COMPARED WITH FIRST QUARTER 2003

The Company's net income for the first quarter of 2004 was \$3.6 million. This represented a \$4.0 million or 52% decrease from first quarter 2003 earnings of \$7.6 million. Earnings decreased primarily because of a \$2.5 million gain on sale of securities in 2003 compared to a \$398 thousand gain realized in 2004.

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First quarter 2004 interest income on the Notes totaled \$258 thousand and yielded 6.4% on \$16.1 million of average principal outstanding for the quarter compared to \$472 thousand and a 6.4% yield on \$29.7 million average principal outstanding for first quarter 2003. 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 2004 and 2003 was \$20 million and \$36 million, respectively. Interest income on securities available-for-sale for the current quarter was \$2.7 million resulting in a yield of 4.4% on an average balance of \$243 million, compared to \$4.6 million with a yield of 5.0% on an average balance of \$368 million for the same period a year ago. The decrease in interest income is primarily attributable to the reduction in the investment portfolio of mortgage-backed securities.

There were no Company borrowings during first quarter 2004 or 2003.

First quarter 2004 operating expenses totaled \$137 thousand, an increase of \$7 thousand or 5% from the first quarter of 2003. Loan servicing expenses totaled \$12 thousand, a decrease of \$10 thousand or 45% 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 2004 were \$29 thousand compared to \$10 thousand a year earlier, due to increased costs for processing, recordkeeping and administration. General and administrative expenses totaled \$96 thousand, a decrease of \$2 thousand over the same period in 2003.

At March 31, 2004 and 2003, there were no Securing Mortgage Loans on nonaccrual status.

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.

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As presented in the accompanying Consolidated Statements of Cash Flows, the primary sources of funds in addition to \$3.4 million provided from operations during the three months ended March 31, 2004 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. In the prior period ended March 31, 2003, the primary sources of funds other than \$5.5 million from operations were \$3.8 million provided by principal repayments on the Notes and \$144.8 million from the maturities and sales of securities available-for-sale. The primary uses of funds for the three months ended March 31, 2004 were \$250 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, 2003, the primary

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HARRIS PREFERRED CAPITAL CORPORATION

uses of funds were \$149.9 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, 2003.

OTHER MATTERS

As of March 31, 2004, 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 Internal Revenue Code. The Company expects to meet all REIT requirements regarding the ownership of its stock and anticipates meeting the annual distribution requirements.

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HARRIS PREFERRED CAPITAL CORPORATION

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.

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HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CONDITION

	MARCH 31 2004	DECEMBER 31 2003	MARCH 31 2003
	-----	-----	-----
	(UNAUDITED)	(AUDITED)	(UNAUDITED)
	(IN THOUSANDS EXCEPT SHARE DATA)		
ASSETS			
Cash and demand balances due from banks.....	\$ 901,871	\$ 823,615	\$ 1,244,415
Money market assets:			
Interest-bearing deposits at banks.....	515,190	424,459	321,090

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(UNAUDITED)

	QUARTER ENDED MARCH 31	
	2004	2003
	(IN THOUSANDS EXCEPT SHARE DATA)	
INTEREST INCOME		
Loans, including fees.....	\$120,479	\$117,492
Money market assets:		
Deposits at banks.....	877	993
Federal funds sold and securities purchased under agreement to resell.....	1,427	695
Trading account.....	372	453
Securities available-for-sale:		
U.S. Treasury and Federal agency.....	33,393	42,509
State and municipal.....	279	5
Other.....	683	1,121
Total interest income.....	157,510	163,268
INTEREST EXPENSE		
Deposits.....	34,679	30,319
Short-term borrowings.....	9,896	14,220
Senior notes.....	126	895
Minority interest-dividends on preferred stock of subsidiary.....	4,609	4,609
Long-term notes.....	2,578	2,677
Total interest expense.....	51,888	52,720
NET INTEREST INCOME.....	105,622	110,548
Provision for loan losses.....	17,325	17,618
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES.....	88,297	92,930
NONINTEREST INCOME		
Trust and investment management fees.....	23,052	19,738
Money market and bond trading.....	2,113	3,125
Foreign exchange.....	1,725	976
Service fees and charges.....	25,058	27,724
Securities gains.....	11,281	2,463
Bank-owned insurance.....	10,388	10,796
Foreign fees.....	6,150	6,218
Other.....	52,351	50,268
Total noninterest income.....	132,118	121,308
NONINTEREST EXPENSES		
Salaries and other compensation.....	74,116	78,768
Pension, profit sharing and other employee benefits.....	20,666	18,123
Net occupancy.....	11,912	9,808
Equipment.....	13,116	13,069
Marketing.....	8,285	7,215
Communication and delivery.....	5,602	5,598
Expert services.....	5,596	6,214
Contract programming.....	8,291	6,343

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Other.....	21,550	20,525
	-----	-----
	169,134	165,663
Goodwill and other valuation intangibles.....	2,596	2,538
	-----	-----
Total noninterest expenses.....	171,730	168,201
	-----	-----
Income before income taxes.....	48,685	46,037
Applicable income taxes.....	13,887	12,615
	-----	-----
NET INCOME.....	\$ 34,798	\$ 33,422
	=====	=====
EARNINGS PER COMMON SHARE (based on 10,000,000 average shares outstanding)		
Net Income.....	\$ 3.48	\$ 3.34
	=====	=====

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 COMPREHENSIVE INCOME
(UNAUDITED)

	QUARTER ENDED MARCH 31	
	2004	2003
	-----	-----
	(IN THOUSANDS)	
NET INCOME.....	\$34,798	\$33,422
OTHER COMPREHENSIVE INCOME:		
Minimum pension liability adjustment net of tax benefit of \$158 in 2004 and zero in 2003.....	(259)	--
Unrealized gains (losses) on available-for-sale securities:		
Unrealized holding gains (losses) arising during the period, net of tax expense (benefit) of \$2,418 in 2004 and (\$5,453) in 2003.....	3,015	(8,216)
Less reclassification adjustment for realized gains included in income statement, net of tax expense of \$4,388 in 2004 and \$958 in 2003.....	(6,893)	(1,505)
	-----	-----
Other comprehensive loss.....	(4,137)	(9,721)
	-----	-----
COMPREHENSIVE INCOME.....	\$30,661	\$23,701
	=====	=====

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)

	2004 ----	2003 ----
(IN THOUSANDS)		
BALANCE AT JANUARY 1.....	\$1,596,629	\$1,577,654
Net income.....	34,798	33,422
Contributions to capital.....	2,989	2,741
Dividends -- preferred stock.....	(108)	(119)
Dividends -- common stock.....	(17,000)	(20,000)
Other comprehensive loss.....	(4,137)	(9,720)
	-----	-----
BALANCE AT MARCH 31.....	\$1,613,171	\$1,583,978
	=====	=====

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)

	QUARTER ENDED MARCH 31	
	2004 ----	2003 ----
(IN THOUSANDS)		
OPERATING ACTIVITIES:		
Net Income.....	\$ 34,798	\$ 33,422
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses.....	17,325	17,617
Depreciation and amortization, including intangibles.....	16,858	16,477
Deferred tax benefit.....	(2,416)	(1,411)
Gain on sales of securities.....	(11,281)	(2,463)
Increase in bank-owned insurance.....	(10,126)	(11,076)
Trading account net cash sales.....	31,543	38,689
Net increase in interest receivable.....	(2,195)	(1,057)
Net (decrease) increase in interest payable.....	(4,387)	4,722
Net decrease (increase) in loans held for sale.....	49,778	(48,342)
Other, net.....	(25,978)	10,979
	-----	-----
Net cash provided by operating activities.....	93,919	57,557
	-----	-----
INVESTING ACTIVITIES:		
Net (increase) decrease in interest-bearing deposits at banks.....	(90,731)	96,116

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Net increase in Federal funds sold and securities		
purchased under agreement to resell.....	(90,319)	(229,925)
Proceeds from sales of securities available-for-sale.....	799,667	44,761
Proceeds from maturities of securities		
available-for-sale.....	927,078	1,180,838
Purchases of securities available-for-sale.....	(1,990,549)	(1,466,830)
Net increase in loans.....	(628,560)	(182,435)
Purchases of premises and equipment.....	(10,898)	(12,624)
Other, net.....	409	--
	-----	-----
Net cash used by investing activities.....	(1,083,903)	(570,099)
	-----	-----
FINANCING ACTIVITIES:		
Net increase in deposits.....	1,125,735	480,387
Net (decrease) increase in Federal funds purchased and		
securities sold under agreement to repurchase.....	(331,271)	189,361
Net increase (decrease) in other short-term borrowings....	90,776	(100,045)
Proceeds from issuance of senior notes.....	200,000	750,000
Repayment of senior notes.....	--	(600,000)
Cash dividends paid on common stock.....	(17,000)	(20,000)
	-----	-----
Net cash provided by financing activities.....	1,068,240	699,703
	-----	-----
NET INCREASE IN CASH AND DEMAND BALANCES DUE FROM		
BANKS.....	78,256	187,161
CASH AND DEMAND BALANCES DUE FROM BANKS AT JANUARY 1....	823,615	1,057,254
	-----	-----
CASH AND DEMAND BALANCES DUE FROM BANKS AT MARCH 31....	\$ 901,871	\$ 1,244,415
	=====	=====

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 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.

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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 \$56.3 million and \$48.0 million in 2004 and 2003, respectively. Cash income tax payments over the same periods totaled \$0.5 million and \$0.1 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 as of March 31, 2004 was \$89.3 million. No impairment was recorded during the quarter ended March 31, 2004.

The Bank did not have any intangible assets not subject to amortization as of March 31, 2004.

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HARRIS TRUST AND SAVINGS BANK AND SUBSIDIARIES

NOTES TO THE FINANCIAL STATEMENTS -- (CONTINUED)

As of March 31, 2004, the gross carrying amount and accumulated amortization of the Bank's amortizable intangible assets are included in the following table.

	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION	NET CAR VALU
	-----	-----	-----
	(IN THOUSANDS)		
Branch network.....	\$145,000	\$ (74,917)	\$70,0
Other.....	5,724	(1,748)	3,9
	-----	-----	-----
Total finite life intangibles.....	\$150,724	\$ (76,665)	\$74,0
	=====	=====	=====

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

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Estimated intangible asset amortization expense for the years ending December 31, 2004, 2005, 2006, 2007 and 2008 is \$10.4 million per year.

FIRST QUARTER 2004 COMPARED WITH FIRST QUARTER 2003

SUMMARY

The Bank had first quarter 2004 net income of \$34.8 million, an increase of \$1.4 million or 4 percent from first quarter 2003.

Cash ROE was 10.13 percent in the current quarter and 10.38 percent in first quarter 2003. Excluding unrealized gains and losses on the securities portfolio recorded directly to equity, cash ROE was 10.34 percent for the current year's first quarter, compared to 10.71 percent a year ago.

First quarter net interest income on a fully taxable equivalent basis was \$108.0 million, down \$5.6 million or 5 percent from \$113.6 million in 2003's first quarter. Average earning assets increased 9 percent to \$17.23 billion from \$15.85 billion in 2003. Average securities available-for-sale increased \$813 million. Net interest margin decreased to 2.52 percent from 2.90 percent in the same quarter last year.

The first quarter 2004 provision for loan losses of \$17.3 million was down slightly from \$17.6 million in the first quarter of 2003. Net charge-offs were \$9.3 million compared to \$16.3 million in the prior year's quarter. The decrease is attributable to lower charge-offs and greater recoveries in the commercial loan portfolio.

First quarter 2004 noninterest income of \$132.1 million increased \$10.8 million from the same quarter last year. Most of the increase was the result of an \$8.8 million increase in net gains from securities sales compared to a year ago quarter. Trust revenue and foreign exchange income increased from first quarter 2003. The Bank also experienced a \$7.1 million gain on the sale of assets received in an earlier troubled debt restructuring and a gain on the termination of a swap.

First quarter 2004 noninterest expenses of \$171.7 million increased \$3.5 million or 2 percent from the year-ago quarter.

Nonperforming assets at March 31, 2004 were \$159 million or 1.56 percent of total loans, compared to \$172 million or 1.79 percent at December 31, 2003 and \$175 million or 1.79 percent a year ago. At March 31, 2004, the allowance for possible loan losses was \$243 million, equal to 2.38 percent of loans outstanding, compared to \$208 million or 2.13 percent at the end of first quarter 2003. As a result, the ratio of the allowance for possible loan losses to nonperforming assets was 152 percent at March 31, 2004 compared to 119 percent at March 31, 2003.

At March 31, 2004, Tier 1 capital of the Bank amounted to \$1.68 billion, up from \$1.59 billion one year earlier. The regulatory leverage capital ratio was 8.51 percent for the first quarter of 2004 compared to 8.70 percent in the same quarter of 2003. The Bank's capital ratio exceeds the prescribed regulatory minimum for banks. The Bank's March 31, 2004 Tier 1 and total risk-based capital ratios were 9.86 percent and 11.81 percent compared to respective ratios of 9.92 percent and 12.12 percent at March 31, 2003.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

See "Liquidity Risk Management" and "Market Risk Management" under

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Management's Discussion and Analysis of Financial Condition and Results of Operations beginning on page 6.

ITEM 4. CONTROLS AND PROCEDURES

As of March 31, 2004, 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 made known to them in a timely fashion. 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, 2004 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. (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:

FORM 8-K WAS FILED ON JANUARY 30, 2004, REPORTING ITEM 4, "CHANGES IN REGISTRANT'S CERTIFYING ACCOUNTANT."

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 May 2004.

/s/ PAUL R. SKUBIC

Paul R. Skubic
Chairman of the Board and President

/s/ JANINE MULHALL

Janine Mulhall
Chief Financial Officer