DOWNEY FINANCIAL CORP
Form 10-Q
May 02, 2001

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended MARCH 31, 2001

OR

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

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

DELAWARE	33-0633413
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
3501 JAMBOREE ROAD, NEWPORT BEACH, CA	92660
(Address of principal executive office)	(Zip Code)

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

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

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

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

NONE

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

At March 31, 2001, 28,211,048 shares of the Registrant's Common Stock, $0.01 par value were outstanding.

DOWNEY FINANCIAL CORP.

MARCH 31, 2001 QUARTERLY REPORT ON FORM 10-Q

TABLE OF CONTENTS

PART I

FINANCIAL INFORMATION.. 1

Consolidated Balance Sheets.................................. 1
Consolidated Statements of Income............................ 2
Consolidated Statements of Comprehensive Income............... 3
Consolidated Statements of Cash Flows......................... 4

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS................................. 6

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS........................... 10

PART II

OTHER INFORMATION.. 34

Item 6 Exhibits and Reports on Form 8-K.................... 34

PART I - FINANCIAL INFORMATION

DOWNEY FINANCIAL CORP. AND SUBSIDIARIES

Consolidated Balance Sheets

(Dollars in Thousands, Except Per Share Data)	March 31, 2001	D
ASSETS		
Cash	$ 114,316	$
Federal funds	7,601	
Cash and cash equivalents	121,917	
U.S. Treasury securities, agency obligations and other investment securities available for sale, at fair value	255,891	
Municipal securities held to maturity, at amortized cost (estimated market value of $6,534 at March 31, 2001 and December 31, 2000, and $6,709 at March 31, 2000)	6,550	
Loans held for sale, at lower of cost or market	446,264	
Mortgage-backed securities available for sale, at fair value	5,842	
Loans receivable held for investment	9,820,116	
Investments in real estate and joint ventures	18,690	
Real estate acquired in settlement of loans	11,634	
Premises and equipment	104,138	
Federal Home Loan Bank stock, at cost	108,223	
Mortgage servicing rights, net	35,717	
Other assets	96,120	
	$11,031,102	$

LIABILITIES AND STOCKHOLDERS' EQUITY	
Deposits	$ 8,708,275
Federal Home Loan Bank advances	1,457,046
Other borrowings	145
Accounts payable and accrued liabilities	64,138
Deferred income taxes	32,906
Total liabilities	10,262,510
Company obligated mandatorily redeemable capital securities of subsidiary trust holding solely junior subordinated debentures of the Company ("Capital Securities")	120,000
STOCKHOLDERS' EQUITY	
Preferred stock, par value of $0.01 per share; authorized 5,000,000 shares; outstanding none	--
Common stock, par value of $0.01 per share; authorized 50,000,000 shares; outstanding 28,211,048 shares at March 31, 2001, 28,205,741 shares at December 31, 2000 and 28,148,409 shares at March 31, 2000	282
Additional paid-in capital	93,374
Accumulated other comprehensive income (loss)	1,182
Retained earnings	553,754
Total stockholders' equity	648,592
	$11,031,102

See accompanying notes to consolidated financial statements.

1

DOWNEY FINANCIAL CORP. AND SUBSIDIARIES

Consolidated Statements of Income

(Dollars in Thousands, Except Per Share Data)	Three Months March 3 2001
INTEREST INCOME:	
Loans receivable	$ 212,762
U.S. Treasury securities and agency obligations	4,410
Mortgage-backed securities	128
Other investments	2,666
Total interest income	219,966
INTEREST EXPENSE:	
Deposits	114,801
Borrowings	25,962
Capital securities	3,041
Total interest expense	143,804
NET INTEREST INCOME	76,162

PROVISION FOR LOAN LOSSES		52	
Net interest income after provision for loan losses		76,110	
OTHER INCOME, NET:			
Loan and deposit related fees		10,230	
Real estate and joint ventures held for investment, net:			
Operations, net		1,031	
Net gains on sales of wholly owned real estate		2	
(Provision for) reduction of losses on real estate and joint ventures		(33)	
Secondary marketing activities:			
Loan servicing fees		(8,185)	
Net gains on sales of loans and mortgage-backed securities		2,125	
Net gains on sales of investment securities		125	
Gain on sale of subsidiary		--	
Other		656	
Total other income, net		5,951	
OPERATING EXPENSE:			
Salaries and related costs		23,271	
Premises and equipment costs		6,043	
Advertising expense		1,176	
Professional fees		577	
SAIF insurance premiums and regulatory assessments		732	
Other general and administrative expense		5,339	
Total general and administrative expense		37,138	
Net operation of real estate acquired in settlement of loans		(2)	
Amortization of excess of cost over fair value of net assets acquired		114	
Total operating expense		37,250	
INCOME BEFORE INCOME TAXES		44,811	
Income taxes		18,983	
Net income before cumulative effect of change in accounting principle		25,828	
Cumulative effect of change in accounting principle, net of income taxes		36	
NET INCOME	$	25,864	$
PER SHARE INFORMATION:			
Basic before cumulative effect of change in accounting principle	$	0.92	$
BASIC AFTER CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE		0.92	
Diluted before cumulative effect of change in accounting principle	$	0.91	$
DILUTED AFTER CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE		0.91	
CASH DIVIDENDS DECLARED AND PAID	$	0.09	$
Weighted average diluted shares outstanding		28,275,184	

See accompanying notes to consolidated financial statements.

DOWNEY FINANCIAL CORP. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income

(In Thousands)	Three Months En March 31, 2001	2
NET INCOME	$25,864	$27
OTHER COMPREHENSIVE INCOME (LOSS), NET OF INCOME TAXES (BENEFITS):		
Unrealized gains (losses) on securities available for sale:		
U.S. Treasury securities, agency obligations and other investment securities available for sale, at fair value	693	
Mortgage-backed securities available for sale, at fair value	33	
Less reclassification of realized (gains) losses included in net income	(72)	
Unrealized gains (losses) on cash flow hedges:		
Net derivative instruments	(935)	
Cumulative effect of a change in accounting principle	(388)	
Less reclassification of realized losses included in net income	1,164	
Total other comprehensive income (loss), net of income taxes (benefits) ..	495	
COMPREHENSIVE INCOME	$26,359	$26

See accompanying notes to consolidated financial statements.

DOWNEY FINANCIAL CORP. AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(In Thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net income	$
Adjustments to reconcile net income to net cash used for operating activities:	
Cumulative effect of change in accounting principle, net of income taxes	
Depreciation and amortization	
Provision for losses on loans, real estate acquired in settlement of loans, investments in real estate and joint ventures, mortgage servicing rights and other assets	
Net gains on sales of loans and mortgage-backed securities, investment securities, real estate and other assets	
Gain on sale of subsidiary	
Interest capitalized on loans (negative amortization)	(
Federal Home Loan Bank stock dividends	
Loans originated for sale	(7

Proceeds from sales of loans held for sale, including those sold via mortgage-backed securities	5
Increase in other, net	
Net cash used for operating activities	(1
CASH FLOWS FROM INVESTING ACTIVITIES:	
Proceeds from sales of:	
Subsidiary, net	
U.S. Treasury securities, agency obligations and other investment securities available for sale	
Wholly owned real estate and real estate acquired in settlement of loans	
Proceeds from maturities of U.S. Treasury securities, agency obligations and other investment securities available for sale	2
Purchase of:	
U.S. Treasury securities, agency obligations and other investment securities available for sale	(1
Loans receivable held for investment	
Federal Home Loan Bank stock	
Loans receivable originated held for investment (net of refinances of $146,113 at March 31, 2001 and $33,564 at March 31, 2000)	(5
Principal payments on loans receivable held for investment and mortgage-backed securities available for sale	5
Net change in undisbursed loan funds	(
Investments in real estate held for investment	
Other, net	
Net cash provided by (used for) investing activities	

See accompanying notes to consolidated financial statements.

4

DOWNEY FINANCIAL CORP. AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Continued)

(In Thousands)	
CASH FLOWS FROM FINANCING ACTIVITIES:	
Net increase in deposits	$
Proceeds from Federal Home Loan Bank advances	
Repayments of Federal Home Loan Bank advances	(1
Net decrease in other borrowings	
Proceeds from exercise of stock options	
Cash dividends	
Net cash provided by financing activities	
Net decrease in cash and cash equivalents	
Cash and cash equivalents at beginning of period	

CASH AND CASH EQUIVALENTS AT END OF PERIOD	$
Supplemental disclosure of cash flow information:	
Cash paid during the period for:	
Interest	$
Income taxes	
Supplemental disclosure of non-cash investing:	
Loans transferred from held for sale to held for investment	
Loans exchanged for mortgage-backed securities	
Real estate acquired in settlement of loans	
Loans to facilitate the sale of real estate acquired in settlement of loans	

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE (1) - BASIS OF FINANCIAL STATEMENT PRESENTATION

In the opinion of Downey Financial Corp. and subsidiaries ("Downey," "we," "us" and "our"), the accompanying consolidated financial statements contain all adjustments (consisting of only normal recurring accruals) necessary for a fair presentation of Downey's financial condition as of March 31, 2001, December 31, 2000 and March 31, 2000 and the results of operations, comprehensive income, and changes in cash flows for the three months ended March 31, 2001 and 2000. Certain prior period amounts have been reclassified to conform to the current period presentation.

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial operations and are in compliance with the instructions for Form 10-Q and therefore do not include all information and footnotes necessary for a fair presentation of financial condition, results of operations, comprehensive income and cash flows. The following information under the heading Management's Discussion and Analysis of Financial Condition and Results of Operations is written with the presumption that the interim consolidated financial statements will be read in conjunction with Downey's Annual Report on Form 10-K for the year ended December 31, 2000, which contains among other things, a description of the business, the latest audited consolidated financial statements and notes thereto, together with Management's Discussion and Analysis of Financial Condition and Results of Operations as of December 31, 2000 and for the year then ended. Therefore, only material changes in financial condition and results of operations are discussed in the remainder of Part I.

NOTE (2) - NET INCOME PER SHARE

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

The following table presents a reconciliation of the components used to derive basic and diluted earnings per share both before and after the cumulative effect of change in accounting principle for the periods indicated.

(Dollars in Thousands, Except Per Share Data)	Three Months Ende	
	2001	
	Net Income	Per Share Amount
BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE:		
Basic earnings per share	$25,828	$0.92
Effect of dilutive stock options	--	0.01
Diluted earnings per share	$25,828	$0.91
AFTER CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE:		
Basic earnings per share	$25,864	$0.92
Effect of dilutive stock options	--	0.01
Diluted earnings per share	$25,864	$0.91
WEIGHTED AVERAGE SHARES OUTSTANDING:		
Basic		28,209,678
Dilutive stock options		65,506
Diluted		28,275,184

NOTE (3) - BUSINESS SEGMENT REPORTING

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

(In Thousands)	Banking	Real Estate Investment	Elimination	Totals
THREE MONTHS ENDED MARCH 31, 2001:				
Net interest income	$ 76,134	$ 28	$ --	$ 76,1
Provision for loan losses	52	--	--	
Other income	4,683	1,268	--	5,9
Operating expense	36,990	260	--	37,2
Net intercompany income (expense)	97	(97)	--	--
Income before income taxes	43,872	939	--	44,8
Income taxes	18,599	384	--	18,9
Net income before cumulative effect of change in accounting principle	25,273	555	--	25,8
Cumulative effect of change in accounting				

principle, net of income taxes	36	--	--	
Net income	$ 25,309	$ 555	$ --	$ 25,8
AT MARCH 31, 2001:				
Assets				
Loans and mortgage-backed securities	$10,272,222	$ --	$ --	$10,272,2
Real estate held for investment	--	18,690	--	18,6
Other	755,324	3,337	(18,471)	740,1
Total assets	11,027,546	22,027	(18,471)	11,031,1
Equity	$ 648,592	$ 18,471	$ (18,471)	$ 648,5
THREE MONTHS ENDED MARCH 31, 2000:				
Net interest income	$ 62,715	$ 48	$ --	$ 62,7
Provision for loan losses	791	--	--	7
Other income:				
Gain on sale of subsidiary	9,762	--	--	9,7
All other	8,585	3,130	--	11,7
Operating expense	35,484	241	--	35,7
Net intercompany income (expense)	108	(108)	--	--
Income before income taxes	44,895	2,829	--	47,7
Income taxes	19,128	1,160	--	20,2
Net income	$ 25,767	$ 1,669	$ --	$ 27,4
AT MARCH 31, 2000:				
Assets				
Loans and mortgage-backed securities	$ 9,280,629	$ --	$ --	$ 9,280,6
Real estate held for investment	--	40,571	--	40,5
Other	672,124	7,193	(41,508)	637,8
Total assets	9,952,753	47,764	(41,508)	9,959,0
Equity	$ 556,851	$ 41,508	$ (41,508)	$ 556,8

NOTE (4) - MORTGAGE SERVICING RIGHTS

The following table sets forth information concerning mortgage servicing right activity, allowance and estimated fair value as well as mortgage loans serviced for others at the dates indicated.

	Three Months Ended			
(Dollars in Thousands)	March 31, 2001	December 31, 2000	September 30, 2000	
Gross balance at beginning of period	$ 46,214	$ 45,834	$ 41,126	$
Additions	5,394	2,548	6,267	
Amortization	(2,063)	(1,803)	(1,559)	

Impairment write-down	(222)	(365)	--	
Gross balance at end of period	49,323	46,214	45,834	
Allowance balance at beginning of period	5,483	820	214	
Provision for impairment	8,345	5,028	606	
Impairment write-down	(222)	(365)	--	
Allowance balance at end of period	13,606	5,483	820	
Mortgage servicing rights, net	$ 35,717	$ 40,731	$ 45,014	$
Estimated fair value (1)	$ 35,752	$ 41,826	$ 45,895	$
Mortgage loans serviced for others:				
Total	$4,296,883	$3,964,462	$4,020,931	$3
With capitalized mortgage servicing rights:				
Amount	3,999,380	3,779,562	3,686,763	3
Weighted average interest rate	7.50%	7.56%	7.51%	
Custodial escrow balances	$ 5,281	$ 8,207	$ 11,378	$

NOTE (5) - ACCOUNTING FOR DERIVATIVES AND HEDGING ACTIVITIES

On January 1, 2001, we adopted Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended, ("SFAS 133"). SFAS 133 required the recognition of all derivative financial instruments at fair value and reported as either assets or liabilities in the balance sheet. The accounting for gains and losses associated with changes in the fair value of derivatives are reported in current earnings or other comprehensive income, net of tax, depending on whether they qualify for hedge accounting and whether the hedge is highly effective in achieving offsetting changes in the fair value or cash flows of the asset or liability hedged. Under the provisions of SFAS 133, the method used for assessing the effectiveness of a hedging derivative, as well as the measurement approach for determining the ineffective aspects of the hedge, must have been established at the inception of the hedge. Those methods must also be consistent with the entity's approach to managing risk. Although we continue to hedge as previously done, SFAS 133, as applied to our risk management strategies, may increase or decrease reported net income and stockholders' equity, depending on levels of interest rates and other variables affecting the fair values of derivative instruments and hedged items, but will have no effect on actual cash flows or the overall economics of the transactions.

With the implementation of SFAS 133, we recorded after-tax transition amounts associated with establishing the fair values of the derivative instruments and hedged items on the balance sheet as an increase of $36,000 to net income and a reduction of $388,000 in other comprehensive income. All of the other comprehensive income transition amount was reclassified into earnings during the first quarter of 2001.

Derivatives

We offer short-term interest rate lock commitments to help us attract potential home loan borrowers. The rate locks guarantee a specified interest rate for a loan if our underwriting standards are met, but do not obligate the potential borrower. The rate lock commitments we ultimately expect to sell in the secondary market are treated as derivatives. Consequently, as derivatives, the expected rate lock commitments do not qualify for hedge accounting.

Associated fair

value adjustments are recorded in the balance sheet in either other assets or accounts payable and accrued liabilities, with an offset to current earnings under net gains on sales of loans and mortgage-backed securities. At March 31, 2001, we had rate lock commitments estimated to sell as part of our secondary marketing activities of $337 million. At origination, the fair value of our rate lock derivatives are capitalized into the basis of our loans held for sale and, from that point until sale, qualify for hedge accounting under SFAS 133.

Hedging Activities

As part of our secondary marketing activities, we typically utilize short-term forward sale and purchase contracts to offset the impact of changes in market interest rates on the value of rate lock derivatives and loans originated for sale. Contracts associated with originated loans are accounted for as cash flow hedges. These contracts have a high correlation to the price movement of both the rate lock derivatives and the loans being hedged. Changes in forward sale contract values not assigned to originated loans and the ineffectiveness of hedge transactions are recorded in net gains on sales of loans and mortgage-backed securities. The changes in values on forward sale contracts assigned as cash flow hedges to originated loans are recorded in other comprehensive income, net of tax, as long as cash flow hedge requirements are met. The amounts recorded in accumulated other comprehensive income will be recognized in the income statement when the hedged forecasted transactions settle. We estimate that all of the related unrealized losses in accumulated other comprehensive income will be reclassified into earnings within the next three months. At March 31, 2001, forward sale contracts amounted to $780 million, of which $400 million were designated as cash flow hedges, and forward purchase contracts totaled $8 million.

NOTE (6) - INCOME TAXES

Downey and its wholly owned subsidiaries file a consolidated federal income tax return and various state income and franchise tax returns on a calendar year basis. The Internal Revenue Service and state taxing authorities have examined Downey's tax returns for all tax years through 1995 and are currently reviewing returns filed for the 1996 tax year. Adjustments proposed by the Internal Revenue Service have been protested by Downey and are currently moving through the government appeals process. Downey believes it has established appropriate liabilities for any resultant deficiencies. Tax years subsequent to 1996 remain open to review by federal and state tax authorities.

NOTE (7) - SALE OF SUBSIDIARY

On February 29, 2000, Downey Savings and Loan Association, F.A. sold its indirect automobile finance subsidiary, Downey Auto Finance Corp., to Auto One Acceptance Corp., a subsidiary of California Federal Bank and recognized a pre-tax gain from the sale of $9.8 million. As of December 31, 1999, Downey Auto Finance Corp. had loans totaling $366 million and total assets of $373 million.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION

AND RESULTS OF OPERATIONS

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

OVERVIEW

Our net income for the first quarter of 2001 totaled $25.9 million or $0.91 per share on a diluted basis, compared to $27.4 million or $0.97 per share in the same period a year ago. Included in our year-ago results was a $5.6 million or $0.20 per share after-tax gain from the sale of our indirect automobile finance subsidiary. If the year-ago gain is excluded, our net income in the current quarter would have increased by $4.1 million or 18.5%. On January 1, 2001, we adopted Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended, ("SFAS 133") and, as a result, recorded an immaterial cumulative effect of change in accounting principle.

The increase in our adjusted net income between first quarters was due to higher net income from our banking operations, as net income from our real estate investment activities declined from $1.7 million in the first quarter of 2000 to $0.6 million in the current quarter. On an adjusted basis, net income from our banking operations increased $5.2 million or 25.6% to $25.3 million reflecting the following:

- net interest income increased $13.4 million or 21.4% due to increases in both average earning assets and the effective interest rate spread; and
- provision for loan losses declined by $0.7 million.

Those favorable items were partially offset by an increase of $1.5 million in operating expenses associated with an increased number of branch locations and higher loan origination activity. In addition, other income declined by $3.9 million, as higher loan and deposit related fees, and net gains on sales of loans and mortgage-backed securities were unable to offset an $8.3 million addition to the valuation allowance for mortgage servicing rights due to the continued drop in fixed rate mortgage interest rates during the quarter and the expectation of higher loan prepayments in future periods.

For the first quarter of 2001, our return on average assets was 0.94% and our return on average equity was 16.28%.

At March 31, 2001, our assets totaled $11.0 billion, up $1.1 billion or 10.8% from a year ago. Our single family loan originations totaled $1.438 billion in the first quarter of 2001, down 4.1% from the $1.499 billion originated in the first quarter of 2000. Of the current quarter total, $641 million represented originations of loans for portfolio, of which $135 million represented subprime credits. In addition to single family loans, we originated $29 million of other loans in the quarter.

Between first quarters, we funded our asset growth with a $1.7 billion or 25.1% increase in deposits. At quarter-end, our deposits totaled $8.7 billion. During the quarter, seven new in-store branches were opened, bringing our total branches at quarter end to 121, of which 56 are in-store. A year ago, branches totaled 104, of which 40 were in-store.

Our non-performing assets increased $4 million during the quarter to $59 million or 0.53% of total assets. This increase was due to a rise in residential subprime non-performers of $6 million and a $1 million commercial loan placed on non-accrual. Those increases were partially offset by a $4 million decline in residential non-performers.

At March 31, 2001, our primary subsidiary, Downey Savings and Loan Association, F.A. (the "Bank") had core and tangible capital ratios of 6.55% and a risk-based capital ratio of 13.09%. These capital levels were substantially above the "well capitalized" standards defined by regulation of 5% for core and tangible capital and 10% for risk-based capital.

RESULTS OF OPERATIONS

NET INTEREST INCOME

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

Our net interest income totaled $76.2 million in the first quarter of 2001, up $13.4 million or 21.3% from the same period last year. The improvement between first quarters reflected increases in both average earning assets and the effective interest rate spread. Our average earning assets increased by $1.3 billion or 14.4% between first quarters to $10.6 billion. Our effective interest rate spread of 2.87% in the current quarter was up from 2.71% in both the year-ago quarter and fourth quarter of 2000. Although market interest rates declined during the current quarter, the yield on our adjustable rate mortgage loans continued to rise due to the administrative lag in the Federal Home Loan Bank ("FHLB") Eleventh District Cost of Funds Index ("COFI"), the index to which the majority of our loans are priced. Therefore, our earning asset yield increased more rapidly than our cost of funds.

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

- interest income from average interest-earning assets and the resultant yields; and
- interest expense on average interest-bearing liabilities and the resultant costs, expressed as rates.

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

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

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

	Three Months Ended					
	March 31, 2001			December 31, 2000		
(Dollars in Thousands)	Average Balance	Interest	Average Yield/ Rate	Average Balance	Interest	Avera Yiel Rat
Interest-earning assets:						
Loans	$10,180,942	$212 762	8.36%	$ 9,803,336	$203,336	8.3
Mortgage-backed securities	7,761	128	6.60	11,282	184	6.5
Investment securities	431,023	7,076	6.66	378,359	6,255	6.5
Total interest-earning assets	10,619,726	219,966	8.29	10,192,977	209,775	8.2
Non-interest-earning assets	353,887			341,736		
Total assets	$10,973,613			$10,534,713		
Transaction accounts:						
Non-interest-bearing checking .	$ 246,246	$ --	-- %	$ 228,353	$ --	--
Interest-bearing checking (1) .	396,484	633	0.65	386,301	778	0.8
Money market	89,259	626	2.84	88,956	636	2.8
Regular passbook	766,948	6,427	3.40	764,511	6,570	3.4
Total transaction accounts ..	1,498,937	7,686	2.08	1,468,121	7,984	2.1
Certificates of deposit	6,873,614	107,115	6.32	6,394,378	100,910	6.2
Total deposits	8,372,551	114,801	5.56	7,862,499	108,894	5.5
Borrowings	1,716,077	25,962	6.14	1,814,189	28,903	6.3
Capital securities	120,000	3,041	10.14	120,000	3,041	10.1
Total deposits, borrowings and capital securities	10,208,628	143,804	5.71	9,796,688	140,838	5.7
Other liabilities	129,588			124,765		
Stockholders' equity	635,397			613,260		
Total liabilities and stockholders' equity	$10,973,613			$10,534,713		
Net interest income/interest rate spread		$ 76,162	2.58%		$ 68,937	2.5
Excess of interest-earning assets over deposits, borrowings and capital securities	$ 411,098			$ 396,289		
Effective interest rate spread ..			2.87			2.7

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

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

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

	Three Months Ended March 31, 2001 Versus March 31, 2000 Changes Due To			
(In Thousands)	Volume	Rate	Rate/ Volume	Net
Interest income:				
Loans	$ 23,808	$ 14,485	$ 1,999	$ 40,292
Mortgage-backed securities	(221)	(8)	5	(224)
Investment securities	1,714	486	183	2,383
Change in interest income	25,301	14,963	2,187	42,451
Interest expense:				
Transaction accounts:				
Interest-bearing checking (1) .	66	(347)	(23)	(304)
Money market	(27)	2	--	(25)
Regular passbook	(519)	(456)	29	(946)
Total transaction accounts ..	(480)	(801)	6	(1,275)
Certificates of deposit	21,277	10,412	3,154	34,843
Total interest-bearing deposits	20,797	9,611	3,160	33,568
Borrowings	(5,875)	1,696	(337)	(4,516)
Capital securities	--	--	--	--
Change in interest expense	14,922	11,307	2,823	29,052
Change in net interest income	$ 10,379	$ 3,656	$ (636)	$ 13,399

PROVISION FOR LOAN LOSSES

Provision for loan losses was $0.1 million in the current quarter, down from $0.8 million in the first quarter of 2000. For information regarding our allowance for loan losses, see Financial Condition--Problem Loans and Real Estate--Allowance for Losses on Loans and Real Estate on page 29.

OTHER INCOME

Our total other income was $6.0 million in the first quarter of 2001, down $15.5 million from a year ago. Included in the year-ago amount was a $9.8 million gain from the sale of our indirect auto finance subsidiary. Excluding that gain, other income in the current quarter would have declined by $5.8 million primarily due to:

- an $8.2 million loss in loan servicing fees compared to income of $0.3 million; and
- a $2.1 million decline in income from real estate held for investment activities.

Those declines were partially offset by an increase of $4.4 million in our loan and deposit related fees and $0.3 million in net gains on sales of loans and mortgage-backed securities. Below is a further discussion of the major other income categories.

Loan and Deposit Related Fees

Loan and deposit related fees totaled $10.2 million in the first quarter of 2001, up $4.4 million from a year ago. Our loan related fees accounted for $3.3 million of the increase between first quarters, of which $2.9 million represented higher loan prepayment fees. Our deposit related fees increased by $1.1 million or 38.9%, of which $0.3 million were fees from automated teller machines.

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

	Three Months Ended				
(In Thousands)	March 31, 2001	December 31, 2000	September 30, 2000	June 30, 2000	March 31 2000
Loan related fees:					
Prepayment fees	$ 4,525	$ 3,899	$ 3,043	$ 2,604	$ 1,649
Other fees	1,779	1,513	1,329	1,338	1,347
Deposit related fees:					
Automated teller machine fees	1,533	1,618	1,566	1,362	1,246
Other fees	2,393	2,270	2,021	1,703	1,581
Total loan and deposit related fees	$10,230	$ 9,300	$ 7,959	$ 7,007	$ 5,823

Real Estate and Joint Ventures Held for Investment

Income from our real estate and joint ventures held for investment totaled $1.0 million in the first quarter of 2001, down from $3.1 million a year ago. Our income from real estate held for investment decreased by $2.1 million, due primarily to lower net gains on sales that totaled $0.4 million in the current quarter, compared to $1.7 million in the year-ago quarter. In addition, our net rental income declined by $0.5 million due to fewer properties being owned.

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

	Three Months Ended			
(In Thousands)	March 31, 2001	December 31, 2000	September 30, 2000	J
Operations, net:				
Rental operations, net of expenses	$ 508	$ 309	$ 422	$
Equity in net income from joint ventures	391	169	1,531	
Interest from joint venture advances	132	200	215	
Total operations, net	1,031	678	2,168	
Net gains on sales of wholly owned real estate	2	303	1,257	
Reduction of (provision for) losses on real estate and joint ventures	(33)	(36)	600	
Income from real estate and joint ventures held for investment	$ 1,000	$ 945	$ 4,025	$

Secondary Marketing Activities

Sales of loans and mortgage-backed securities we originated increased in the first quarter of 2001 to $597 million from $331 million a year ago. Net gains associated with these sales totaled $2.1 million in the first quarter of 2001, up from $1.8 million a year ago. The net gains included capitalized mortgage servicing rights of $5.4 million in the first quarter of 2001, compared to $4.2 million a year ago..

A loss of $8.2 million was recorded in loan servicing fees from our portfolio of loans serviced for others during the first quarter of 2001, compared to income of $0.3 million a year ago. The loss in the 2001 first quarter reflects an increase of $8.3 million in the valuation allowance for mortgage servicing rights due to lower interest rates and expectation of higher loan prepayments in future periods. At March 31, 2001, we serviced $4.3 billion of loans for others compared to $4.0 billion at December 31, 2000 and $3.2 billion at March 31, 2000.

The following table presents a breakdown of the components of our loan servicing fees. For further information regarding mortgage servicing rights, see Notes To Consolidated Financial Statements--Note (4)--Mortgage Servicing Rights on page 8.

(In Thousands)	Three Months Ended March 31, 2001	December 31, 2000	September 30, 2000	June 30, 2000	March 31, 2000
Income from servicing operations	$ 2,223	$ 2,718	$ 2,086	$ 1,890	$ 1,720
Amortization of MSRs	(2,063)	(1,803)	(1,559)	(1,363)	(1,243)
Provision for impairment	(8,345)	(5,028)	(606)	(214)	(226)
Loan servicing fees	$(8,185)	$(4,113)	$ (79)	$ 313	$ 251

OPERATING EXPENSE

Operating expense totaled $37.3 million in the current quarter, up $1.5 million from the first quarter of 2000. The increase was due to a $1.8 million or 5.0% increase in general and administrative expense. That increase was primarily due to higher costs associated with the increased number of branch locations and higher loan origination activity.

The following table presents a breakdown of our operating expense for the periods indicated.

(In Thousands)	Three Months Ended March 31, 2001	December 31, 2000	September 30, 2000	June 30, 2000
Salaries and related costs	$ 23,271	$ 21,743	$ 19,280	$ 19,974
Premises and equipment costs	6,043	5,945	5,837	5,803
Advertising expense	1,176	1,121	980	812
Professional fees	577	1,274	537	688
SAIF insurance premiums and regulatory assessments	732	696	683	627
Other general and administrative expense	5,339	5,188	4,823	4,817
Total general and administrative expense .	37,138	35,967	32,140	32,721
Net operation of real estate acquired in settlement of loans	(2)	263	221	87
Amortization of excess of cost over fair value of net assets acquired	114	114	115	116
Total operating expense	$ 37,250	$ 36,344	$ 32,476	$ 32,924

PROVISION FOR INCOME TAXES

Income taxes for the first quarter, including the taxes on the cumulative effect of change in accounting principle, totaled $19.0 million, resulting in an effective tax rate of 42.4%, compared to $20.3 million and 42.5% for the like quarter of a year ago. For further information regarding income taxes, see Notes To Consolidated Financial Statements--Note (6) --Income Taxes on page 9.

BUSINESS SEGMENT REPORTING

The previous sections of the Results of Operations discussed our consolidated results. The purpose of this section is to present data on the results of operations of our two business segments--banking and real estate investment. For further information regarding business segments, see Notes To Consolidated Financial Statements--Note (3) --Business Segment Reporting on page 7.

The following table presents by business segment our net income for the periods indicated, followed by a discussion of the results of operations of each segment.

	Three Months Ended				
(In Thousands)	March 31, 2001	December 31, 2000	September 30, 2000	June 30, 2000	March 31, 2000
Banking net income	$25,309	$22,738	$24,080	$22,237	$25,767
Real estate investment net income	555	257	2,258	245	1,669
Total net income	$25,864	$22,995	$26,338	$22,482	$27,436

Banking

Net income from our banking operations for the first quarter of 2001 totaled $25.3 million, down from $25.8 million in the first quarter of 2000. The sale of our indirect automobile finance subsidiary benefited our first quarter 2000 net income by $5.6 million. Excluding that gain, net income from our banking operations would have increased by $5.2 million or 25.6% from a year ago.

The adjusted increase between first quarters primarily reflected higher net interest income. Net interest income increased $13.4 million or 21.4% due to an increase in both our average earning assets and our effective interest rate spread. Also favorably impacting our banking net income was a $0.7 million decline in provision for loan losses. These favorable items were partially offset by an increase of $1.5 million in operating expense and a decline of $3.9 million in all other income. The increase in operating expense was due to higher general and administrative costs associated with the increased number of branch locations and higher loan origination activity. The decline in all other income was primarily due to an $8.3 million addition to the valuation allowance for mortgage servicing rights, partially offset by increases in loan and deposit related fees and net gains on sales of loans and mortgage-backed securities.

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

(In Thousands)	Three Months Ended March 31, 2001	December 31, 2000	September 30, 2000	June 30, 2000
Net interest income	$ 76,134	$ 68,879	$ 67,137	$ 63,501
Provision for loan losses	52	511	1,007	942
Other income:				
Gain on sale of subsidiary	--	--	--	--
All other	4,683	6,466	7,953	8,640
Operating expense	36,990	35,738	32,216	32,558
Net intercompany income	97	99	83	107
Income before income taxes	43,872	39,195	41,950	38,748
Income taxes	18,599	16,457	17,870	16,511
Net income before cumulative effect of change in accounting principle	25,273	22,738	24,080	22,237
Cumulative effect of change in accounting principle, net of income taxes	36	--	--	--
Net income (1)	$ 25,309	$ 22,738	$ 24,080	$ 22,237
AT PERIOD END:				
Assets:				
Loans and mortgage-backed securities .	$10,272,222	$10,084,353	$ 9,646,741	$ 9,787,661
Other	755,324	806,201	715,933	683,771
Total assets	11,027,546	10,890,554	10,362,674	10,471,432
Equity	$ 648,592	$ 624,636	$ 602,624	$ 577,496

17

Real Estate Investment

Net income from our real estate investment operations totaled $0.6 million in the first quarter of 2001, down $1.1 million from the year-ago quarter. The decline was primarily attributed to lower net gains on sales that totaled $0.4 million in the current quarter, compared to $1.7 million in the year-ago quarter. Also contributing to the decline in income from real estate held for investment was a lower level of net rental income due to fewer properties being owned.

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

Three Months Ended

(In Thousands)	March 31, 2001	December 31, 2000	September 30, 2000	June 30, 2000
Net interest income	$ 28	$ 58	$ 73	$ 64
Other income	1,268	1,079	4,112	827
Operating expense	260	606	260	366
Net intercompany expense	97	99	83	107
Income before income taxes	939	432	3,842	418
Income taxes	384	175	1,584	173
Net income	$ 555	$ 257	$ 2,258	$ 245
AT PERIOD END:				
Assets:				
Investment in real estate and joint ventures	$18,690	$17,641	$15,851	$39,256
Other	3,337	3,584	6,347	7,655
Total assets	22,027	21,225	22,198	46,911
Equity	$18,471	$17,916	$17,659	$41,753

Our investment in real estate and joint ventures amounted to $19 million at March 31, 2001, compared to $18 million at December 31, 2000 and $41 million at March 31, 2000.

For information on valuation allowances associated with real estate and joint venture loans, see Financial Condition--Problem Loans and Real Estate--Allowances for Losses on Loans and Real Estate on page 29.

18

FINANCIAL CONDITION

LOANS AND MORTGAGE-BACKED SECURITIES

Total loans and mortgage-backed securities, including those we hold for sale, increased $188 million during the first quarter to a total of $10.3 billion or 93.1% of assets at March 31, 2001. The increase represents a higher level of single family loans held for sale which increased $195 million during the quarter.

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

	Three Months Ended			
(In Thousands)	March 31, 2001	December 31, 2000	September 30, 2000	June 30, 2000
Loans originated for investment:				
Residential, one-to-four units:				
Adjustable	$ 636,988	$ 887,064	$ 382,828	$ 842,899

Fixed	4,117	2,713	3,896	4,192
Other	28,964	57,901	82,343	40,554
Total loans originated for investment	670,069	947,678	469,067	887,645
Loans originated for sale (1)	796,801	335,726	482,595	542,983
Total loans originated	$1,466,870	$1,283,404	$ 951,662	$1,430,628

Originations of one-to-four unit residential loans totaled $1.438 billion in the first quarter of 2001, of which $641 million were for portfolio and $797 million were for sale. This was 17.3% above the $1.226 billion originated in the fourth quarter of 2000, but 4.1% lower than the $1.499 billion we originated in the year-ago first quarter. Of the current quarter originations for portfolio, $135 million represented originations of subprime credits as part of our continuing strategy to enhance the portfolio's net yield. During the current quarter, 71% of our residential one-to-four unit originations represented refinancing transactions. This is up from 52% in the previous quarter and 45% in the year-ago first quarter. In addition to single family loans, we originated $29 million of other loans in the current quarter.

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

Our adjustable rate mortgages generally:

- begin with an incentive interest rate, which is an interest rate below the current market rate, that adjusts to the applicable index plus a defined spread, subject to periodic and lifetime caps, after one, three, six or twelve months;

- provide that the maximum interest rate we can charge borrowers cannot exceed the incentive rate by more than six to nine percentage points, depending on the type of loan and the initial rate offered; and

- limit interest rate adjustments to 1% per adjustment period for those that adjust semi-annually and 2% per adjustment period for those that adjust annually.

Most of our adjustable rate mortgages adjust monthly instead of semi-annually. These monthly adjustable rate mortgages:

- have a lifetime interest rate cap, but no specified periodic interest rate adjustment cap;

- have a periodic cap on changes in required monthly payments, which adjust annually; and

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

Regarding negative amortization, if a loan incurs significant negative amortization, then there is an increased risk that the market value of the underlying collateral on the loan would be insufficient to satisfy fully the outstanding principal and interest. We currently impose a limit on the amount of negative amortization, so that the principal plus the added amount cannot exceed 110% of the original loan amount.

At March 31, 2001, $7.1 billion of the adjustable rate mortgages in our loan portfolio were subject to negative amortization of which $170 million represented the amount of negative amortization included in the loan balance.

We also continue to originate residential fixed interest rate mortgage loans to meet consumer demand, but we intend to sell the majority of these loans. We sold $597 million of loans in the first quarter of 2001, compared to $243 million in the previous quarter and $331 million in the first quarter of 2000. All were secured by residential one-to-four unit property, and at March 31, 2001, loans held for sale totaled $446 million.

At March 31, 2001, we had commitments to fund loans amounting to $1.465 billion, of which $1.023 billion were one-to-four unit residential loans being originated for sale in the secondary market, as well as undrawn lines of credit of $83 million and loans in process of $53 million. We believe our current sources of funds will enable us to meet these obligations while exceeding all regulatory liquidity requirements.

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

	Three Mo		
(In Thousands)	March 31, 2001	December 31, 2000	Septembe 200
INVESTMENT PORTFOLIO:			
Loans originated:			
Loans secured by real estate:			
Residential one-to-four units:			
Adjustable	$ 501,945	$ 675,943	$ 339
Adjustable - subprime	135,043	210,915	41
Total adjustable	636,988	886,858	381
Fixed	4,117	2,312	3
Fixed - subprime	--	--	
Residential five or more units:			
Adjustable	--	--	
Fixed	--	163	
Total residential	641,105	889,333	386
Commercial real estate	--	--	22
Construction	18,888	30,767	35
Land	--	9,785	1
Non-mortgage:			
Commercial	165	7,029	4
Automobile	2,091	4,442	6

Other consumer	7,570	5,715	10
Total loans originated	669,819	947,071	466
Real estate loans purchased:			
One-to-four units	--	401	
One-to-four units - subprime	--	206	
Other (1)	250	--	1
Total real estate loans purchased	250	607	2
Total loans originated and purchased	670,069	947,678	469
Loan repayments	(705,116)	(621,199)	(485
Other net changes (2)	32,585	28,565	(65
Net increase (decrease) in loans held for investment .	(2,462)	355,044	(82
SALE PORTFOLIO:			
Residential, one-to-four units:			
Originated whole loans	796,216	333,985	469
Originated whole loans - subprime	--	794	13
Loans purchased	585	947	
Loans transferred from (to) the investment portfolio .	(2,392)	(1,745)	83
Originated whole loans sold	(134,352)	(75,205)	(330
Loans exchanged for mortgage-backed securities	(462,744)	(167,637)	(286
Other net changes	(3,179)	(6,343)	(2
SFAS 133 capitalized basis adjustment (3)	558	--	
Net increase (decrease) in loans held for sale	194,692	84,796	(53
Mortgage-backed securities, net:			
Received in exchange for loans	462,744	167,637	286
Sold	(462,744)	(167,637)	(289
Repayments	(4,417)	(2,459)	(1
Other net changes	56	231	
Net decrease in mortgage-backed securities available for sale	(4,361)	(2,228)	(4
Net increase (decrease) in loans held for sale and mortgage-backed securities available for sale	190,331	82,568	(58
Total net increase (decrease) in loans and mortgage-backed securities	$ 187,869	$ 437,612	$ (140

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

(In Thousands)	March 31, 2001	December 31, 2000	September 2000
INVESTMENT PORTFOLIO:			

Loans secured by real estate:			
Residential one-to-four units:			
Adjustable	$ 7,215,128	$ 7,200,400	$ 6,922,8
Adjustable - subprime	1,748,715	1,726,526	1,634,3
Fixed	437,197	454,838	470,3
Fixed - subprime	16,941	17,388	18,1
Total one-to-four units	9,417,981	9,399,152	9,045,7
Residential five or more units:			
Adjustable	13,462	14,203	14,2
Fixed	5,453	5,257	5,4
Commercial real estate:			
Adjustable	47,583	37,374	36,5
Fixed	114,586	127,230	127,7
Construction	96,564	118,165	120,1
Land	21,230	26,880	26,2
Non-mortgage:			
Commercial	21,312	21,721	23,4
Automobile	36,590	39,614	40,3
Other consumer	58,610	60,653	60,3
Total loans held for investment	9,833,371	9,850,249	9,500,3
Increase (decrease) for:			
Undisbursed loan funds	(59,206)	(72,328)	(72,3
Net deferred costs and premiums	80,010	79,109	73,5
Allowance for losses	(34,059)	(34,452)	(34,0
Total loans held for investment, net	9,820,116	9,822,578	9,467,5
SALE PORTFOLIO, NET:			
Loans held for sale:			
One-to-four units	445,706	251,014	163,7
One-to-four units - subprime	--	558	3,0
SFAS 133 capitalized basis adjustment (1)	558	--	--
Total loans held for sale	446,264	251,572	166,7
Mortgage-backed securities available for sale:			
Adjustable	5,835	6,050	6,2
Fixed	7	4,153	6,1
Total mortgage-backed securities available for sale	5,842	10,203	12,4
Total loans held for sale and mortgage-backed securities available for sale	452,106	261,775	179,2
Total loans and mortgage-backed securities	$ 10,272,222	$ 10,084,353	$ 9,646,7

We carry loans for sale at the lower of cost or market. At March 31, 2001, no valuation allowance was required as the market value exceeded book value on an aggregate basis.

At March 31, 2001, our residential one-to-four units subprime portfolio consisted of approximately 73% A-, 22% B and 5% C loans. At March 31, 2001, the average loan-to-value ratio at origination for these loans was approximately 75%.

We carry mortgage-backed securities available for sale at fair value which, at March 31, 2001, reflected an unrealized loss of $9,000. The current quarter-end unrealized loss, less the associated tax effect is reflected within a separate component of other comprehensive income (loss) until realized.

DEPOSITS

At March 31, 2001, deposits totaled $8.7 billion, up $1.7 billion or 25.1% from a year-ago and up $626 million or 7.7% from year-end 2000. Compared to the year-ago period, our certificates of deposit increased $1.6 billion or 29.8% and our transaction accounts--i.e., checking, regular passbook and money market--increased $127 million or 8.3%. Within transaction accounts, our total checking accounts (non-interest and interest bearing) increased $151 million or 25.2%. That increase, however, was partially offset by declines in regular passbook accounts.

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

	March 31, 2001		December 31, 2000		September 30, 2000		June 30, 2	
(Dollars in Thousands)	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	
Transaction accounts:								
Non-interest-bearing checking	- %	$ 335,404	- %	$ 244,311	- %	$ 225,442	- %	$
Interest-bearing checking (1)	0.42	416,636	0.78	395,640	0.78	381,596	0.76	
Money market	2.87	91,733	2.88	89,408	2.87	88,505	2.88	
Regular passbook	3.38	807,503	3.41	754,127	3.42	776,527	3.43	
Total transaction accounts	1.92	1,651,276	2.12	1,483,486	2.18	1,472,070	2.24	1
Certificates of deposit:								
Less than 3.00%	2.14	7,620	2.41	6,357	2.41	7,188	2.48	
3.00-3.49	3.45	26	3.45	25	3.45	26	3.41	
3.50-3.99	3.81	20,748	3.97	384	3.82	1	3.82	
4.00-4.49	4.38	7,279	4.19	26,916	4.23	33,660	4.29	
4.50-4.99	4.72	293,442	4.82	80,844	4.83	162,903	4.81	
5.00-5.99	5.62	2,288,745	5.71	1,901,166	5.69	2,106,639	5.66	3
6.00-6.99	6.64	4,424,756	6.63	4,558,730	6.58	3,889,166	6.49	2
7.00 and greater	7.03	14,383	7.02	24,781	7.02	20,129	7.02	
Total certificates of deposit	6.21	7,056,999	6.33	6,599,203	6.22	6,219,712	5.96	5
Total deposits	5.40%	$8,708,275	5.56%	$8,082,689	5.44%	$7,691,782	5.22%	$7

BORROWINGS

During the 2001 first quarter, our borrowings decreased $521 million to

$1.5 billion, due to a decrease in FHLB advances. This followed an increase of $118 million during the fourth quarter of 2000.

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

(Dollars in Thousands)	March 31, 2001	December 31, 2000	September 30, 2000	Jun 2
Federal Home Loan Bank advances	$1,457,046	$1,978,348	$1,860,255	$2,4
Other borrowings	145	224	248	
Total borrowings	$1,457,191	$1,978,572	$1,860,503	$2,4
Weighted average rate on borrowings during the period	6.14%	6.34%	6.39%	
Total borrowings as a percentage of total assets	13.21	18.16	17.95	

CAPITAL SECURITIES

On July 23, 1999, we issued $120 million in capital securities, of which $108 million was invested as additional common stock in the Bank. The capital securities pay quarterly cumulative cash distributions at an annual rate of 10.00% of the liquidation value of $25 per share. Interest expense including the amortization of deferred issuance costs on our capital securities was $3.0 million for the first quarter of 2001.

ASSET/LIABILITY MANAGEMENT AND MARKET RISK

Market risk is the risk of loss from adverse changes in market prices and interest rates. Our market risk arises primarily from interest rate risk in our lending and deposit taking activities. This interest rate risk occurs to the degree that our interest-bearing liabilities reprice or mature on a different basis--generally more rapidly--than our interest-earning assets. Since our earnings depend primarily on our net interest income, which is the difference between the interest and dividends earned on interest-earning assets and the interest paid on interest-bearing liabilities, one of our principal objectives is to actively monitor and manage the effects of adverse changes in interest rates on net interest income while maintaining asset quality. Our primary strategy to manage interest rate risk is to emphasize the origination of adjustable rate mortgages or loans with relatively short maturities. Interest rates on adjustable rate mortgages are primarily tied to COFI. There has been no significant change in our market risk since December 31, 2000.

The following table sets forth the repricing frequency of our major asset and liability categories as of March 31, 2001, as well as other information regarding the repricing and maturity differences between our interest-earning assets and total deposits, borrowings and capital securities in future periods.

We refer to these differences as "gap." We have determined the repricing frequencies by reference to projected maturities, based upon contractual maturities as adjusted for scheduled repayments and "repricing mechanisms"--provisions for changes in the interest and dividend rates of assets and liabilities. We assume prepayment rates on substantially all of our loan portfolio based upon our historical loan prepayment experience and anticipated future prepayments. Repricing mechanisms on a number of our assets are subject to limitations, such as caps on the amount that interest rates and payments on our loans may adjust, and accordingly, these assets do not normally respond to changes in market interest rates as completely or rapidly as our liabilities. The interest rate sensitivity of our assets and liabilities illustrated in the following table would vary substantially if we used different assumptions or if actual experience differed from the assumptions shown.

	March 31, 20			
(Dollars in Thousands)	Within 6 Months	7 - 12 Months	2 - 5 Years	6 - Yea
Interest-earning assets:				
Investment securities and FHLB stock ..(1)	$ 208,079	$ 73,365	$ 96,752	$
Loans and mortgage-backed securities:				
Loans secured by real estate:				
Residential:				
Adjustable ....(2)	8,656,954	250,128	120,231	
Fixed ....(2)	487,982	33,960	188,889	11
Commercial real estate ....(2)	50,779	16,775	86,029	
Construction ....(2)	46,289	--	--	
Land ....(2)	15,728	9	67	
Non-mortgage loans:				
Commercial ....(2)	14,329	--	--	
Consumer ....(2)	66,225	7,147	20,890	
Mortgage-backed securities ....(2)	5,842	--	--	
Total loans and mortgage-backed securities	9,344,128	308,019	416,106	11
Total interest-earning assets	$ 9,552,207	$ 381,384	$ 512,858	$ 11
Transaction accounts:				
Non-interest-bearing checking:	$ 335,404	$ --	$ --	$
Interest-bearing checking ....(3)	416,636	--	--	
Money market ....(4)	91,733	--	--	
Regular passbook ....(4)	807,503	--	--	
Total transaction accounts	1,651,276	--	--	
Certificates of deposit ....(1)	4,755,955	2,113,677	187,367	
Total deposits	6,407,231	2,113,677	187,367	
Borrowings	967,389	5,066	54,736	43
Capital securities	--	--	--	
Total deposits, borrowings and capital securities	$ 7,374,620	$ 2,118,743	$ 242,103	$ 43
Excess (shortfall) of interest-earning assets over deposits, borrowings and capital securities	$2,177,587	$(1,737,359)	$ 270,755	$ (310
Cumulative gap	2,177,587	440,228	710,983	400

Cumulative gap-- as a % of total assets:			
March 31, 2001	19.74%	3.99%	6.45%
December 31, 2000	28.66	7.13	5.94
March 31, 2000	24.69	14.35	5.20

Our six-month gap at March 31, 2001 was a positive 19.74%. This means more interest-earning assets reprice within six months than total deposits, borrowings and capital securities. This compares to a positive six-month gap of 28.66% at December 31, 2000 and 24.69% at March 31, 2000. We continue to pursue our strategy of emphasizing the origination of adjustable rate mortgages. For the twelve months ended March 31, 2001, we originated and purchased for investment $2.9 billion of adjustable rate loans which represented approximately 98% of all loans we originated and purchased for investment during the period.

At March 31, 2001, 98% of our interest-earning assets mature, reprice or are estimated to prepay within five years, unchanged from December 31, 2000, but up slightly from 97% at March 31, 2000. At March 31, 2001, loans held for investment and mortgage-backed securities with adjustable interest rates represented 90% of those portfolios. During the first quarter of 2001, we continued to offer residential fixed rate loan products to our customers primarily for sale in the secondary market. We price and originate fixed rate mortgage loans for sale into the secondary market to increase opportunities for originating adjustable rate mortgages and generating fee and servicing income. We also originate fixed rate loans for portfolio to facilitate the sale of real estate acquired in settlement of loans and which meet specific yield and other approved guidelines.

At March 31, 2001, $9.4 billion or 91% of our total loan portfolio, including mortgage-backed securities, consisted of adjustable rate loans, construction loans, and loans with a due date of five years or less, compared to $9.4 billion or 93% at December 31, 2000 and $8.7 billion or 93% at March 31, 2000.

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

	March 31, 2001	December 31, 2000	September 30, 2000	June 30, 2000	March 31, 2000
Weighted average yield:					
Loans and mortgage-backed securities	8.56%	8.45%	8.40%	8.03%	7.70%
Federal Home Loan Bank stock	5.51	5.52	5.52	5.52	5.69
Investment securities	6.00	6.45	6.42	6.35	6.12
Earning assets yield	8.46	8.36	8.32	7.97	7.64
Weighted average cost:					
Deposits	5.40	5.56	5.44	5.22	4.95
Borrowings:					
Federal Home Loan Bank advances ..	5.94	6.26	6.37	6.31	5.95
Other borrowings	7.88	8.12	7.88	7.88	7.88
Total borrowings	5.94	6.26	6.37	6.31	5.95

Capital securities	10.00	10.00	10.00	10.00	10.00
Combined funds cost	5.53	5.75	5.68	5.55	5.25
Interest rate spread	2.93%	2.61%	2.64%	2.42%	2.39%

The period-end weighted average yield on our loan portfolio increased to 8.56% at March 31, 2001, up from 8.45% at December 31, 2000 and 7.70% at March 31, 2000. At March 31, 2001, our adjustable rate mortgage portfolio of single family residential loans, including mortgage-backed securities, totaled $9.0 billion with a weighted average rate of 8.65%, compared to $9.0 billion with a weighted average rate of 8.47% at December 31, 2000 and $8.2 billion with a weighted average rate of 7.63% at March 31, 2000.

PROBLEM LOANS AND REAL ESTATE

Non-Performing Assets

Non-performing assets consist of loans on which we have ceased the accrual of interest, which we refer to as non-accrual loans, loans restructured at a below market rate, real estate acquired in settlement of loans and repossessed automobiles. Non-performing assets increased during the quarter by $4 million to $59 million or 0.53% of total assets. This increase was due to a rise in residential subprime non-performers of $6 million and a $1 million commercial loan placed on non-accrual, partially offset by a $4 million decline in residential non-performers. Non-performing assets at quarter end include non-accrual loans aggregating $2 million which were not contractually past due, but were deemed non-accrual due to management's assessment of the borrower's ability to pay.

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

(Dollars in Thousands)	March 31, 2001	December 31, 2000	September 30, 2000	June 200
Non-accrual loans:				
Residential one-to-four units	$16,965	$20,746	$17,976	$18,6
Residential one-to-four units - subprime	26,353	22,296	20,389	19,7
Other	3,367	1,708	1,867	1,5
Total non-accrual loans	46,685	44,750	40,232	39,9
Troubled debt restructure - below market rate (1) ...	205	206	209	2
Real estate acquired in settlement of loans	11,634	9,942	9,161	5,6
Repossessed automobiles	15	76	--	--
Total non-performing assets	$58,539	$54,974	$49,602	$45,8
Allowance for loan losses:				
Amount	$34,059	$34,452	$34,014	$33,2
As a percentage of non-performing loans	72.64%	76.63%	84.11%	82.
Non-performing assets as a percentage of total assets	0.53	0.50	0.48	0.

Delinquent Loans

During the 2001 first quarter, our delinquencies as a percentage of total loans outstanding increased from 0.66% to 0.73%, and were above the 0.53% of a year ago. The increase primarily occurred within our residential one-to-four units subprime category and non-mortgage commercial category.

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

	March 31, 2001					
(Dollars in Thousands)	30-59 Days	60-89 Days	90+ Days (1)	Total	30-59 Days	6
Loans secured by real estate:						
Residential:						
One-to-four units	$14,166	$ 6,961	$15,490	$36,617	$12,400	$
One-to-four units - subprime ...	11,223	6,651	17,860	35,734	7,300	
Five or more units	--	--	508	508	--	
Commercial real estate	--	--	--	--	--	
Construction	--	--	--	--	--	
Land	--	--	--	--	--	
Total real estate loans	25,389	13,612	33,858	72,859	19,700	
Non-mortgage:						
Commercial	--	1,290	--	1,290	--	
Automobile	230	55	74	359	393	
Other consumer	189	31	190	410	98	
Total loans	$25,808	$14,988	$34,122	$74,918	$20,191	$
Delinquencies as a percentage of total loans	0.25%	0.15%	0.33%	0.73%	0.20%	

	September 30, 2000					
Loans secured by real estate:						
Residential:						
One-to-four units	$14,970	$ 3,037	$16,176	$34,183	$ 7,519	$
One-to-four units - subprime ...	7,701	5,422	11,911	25,034	6,270	
Five or more units	--	--	--	--	--	
Commercial real estate	--	--	--	--	--	
Construction	--	--	--	--	--	
Land	--	--	--	--	--	
Total real estate loans	22,671	8,459	28,087	59,217	13,789	
Non-mortgage:						

Commercial	--	--	--	--	--	
Automobile	356	50	116	522	158	
Other consumer	200	86	433	719	372	
Total loans	$23,227	$ 8,595	$28,636	$60,458	$14,319	$
Delinquencies as a percentage of total loans	0.24%	0.09%	0.30%	0.63%	0.15%	

	March 31, 2000			
Loans secured by real estate:				
Residential:				
One-to-four units	$10,388	$ 4,389	$12,974	$27,751
One-to-four units - subprime ...	11,037	3,127	7,092	21,256
Five or more units	--	--	--	--
Commercial real estate	--	--	--	--
Construction	--	--	--	--
Land	--	--	--	--
Total real estate loans	21,425	7,516	20,066	49,007
Non-mortgage:				
Commercial	--	--	--	--
Automobile	150	33	14	197
Other consumer	356	44	137	537
Total loans	$21,931	$ 7,593	$20,217	$49,741
Delinquencies as a percentage of total loans	0.23%	0.08%	0.22%	0.53%

Allowance for Losses on Loans and Real Estate

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

Allowances for losses on all assets were $37 million at March 31, 2001, $38 million at December 31, 2000 and $35 million at March 31, 2000.

Our provision for loan losses was $0.1 million in the current quarter and was below our net loan charge-offs by $0.4 million resulting in a decrease in the allowance for loan losses to $34.1 million at March 31, 2001. The current quarter allowance decrease reflected a decrease of $0.5 million in general valuation allowances to $26.5 million due to declines in various categories of our loan portfolio, while allocated allowances remained virtually unchanged at $4.7 million. There was no change in the unallocated allowance of $2.8 million.

The following table is a summary of the activity in our allowance for loan losses during the periods indicated.

	Three Months Ended				
(In Thousands)	March 31, 2001	December 31, 2000	September 30, 2000	June 30, 2000	March 31, 2000
Balance at beginning of period	$ 34,452	$ 34,014	$ 33,237	$ 32,529	$ 38,342
Provision	52	511	1,007	942	791
Charge-offs	(508)	(346)	(234)	(237)	(932)
Recoveries	63	273	4	3	139
Transfers (1)	--	--	--	--	(5,811)
Balance at end of period	$ 34,059	$ 34,452	$ 34,014	$ 33,237	$ 32,529

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

	Three Months Ended			
(Dollars in Thousands)	March 31, 2001	December 31, 2000	September 30, 2000	June 20
Gross loan charge-offs:				
Loans secured by real estate:				
Residential:				
One-to-four units	$ 268	$ 69	$ 153	$ 1
One-to-four units - subprime	136	136	21	
Five or more units	--	--	--	--
Commercial real estate	--	--	--	--
Construction	--	--	--	--
Land	--	--	--	--
Non-mortgage:				
Commercial	--	--	--	--
Automobile	48	98	--	

Other consumer	56	43	60	
Total gross loan charge-offs	508	346	234	2
Gross loan recoveries:				
Loans secured by real estate:				
Residential:				
One-to-four units	59	19	--	--
One-to-four units - subprime	--	--	--	--
Five or more units	--	--	--	--
Commercial real estate	--	250	--	--
Construction	--	--	--	--
Land	--	--	--	--
Non-mortgage:				
Commercial	--	--	--	--
Automobile	--	--	--	--
Other consumer	4	4	4	
Total gross loan recoveries	63	273	4	
Net loan charge-offs:				
Loans secured by real estate:				
Residential:				
One-to-four units	209	50	153	1
One-to-four units - subprime	136	136	21	
Five or more units	--	--	--	--
Commercial real estate	--	(250)	--	--
Construction	--	--	--	--
Land	--	--	--	--
Non-mortgage:				
Commercial	--	--	--	--
Automobile	48	98	--	
Other consumer	52	39	56	
Total net loan charge-offs	$ 445	$ 73	$ 230	$ 2
Net loan charge-offs as a percentage of average loans	0.02%	-%	0.01%	0.

30

The following table indicates our allocation of the allowance for loan losses to the various categories of loans at the dates indicated.

	March 31, 2001			December 31, 2000			
(Dollars in Thousands)	Allowance	Gross Loan Portfolio Balance	Allowance Percentage to Loan Balance	Allowance	Gross Loan Portfolio Balance	Allowance Percentage to Loan Balance	Al
Loans secured by real estate:							
Residential:							
One-to-four units	$14,613	$7,652,325	0.19%	$15,254	$7,655,238	0.20%	$
One-to-four units -							

subprime	11,057	1,765,656	0.63	10,157	1,743,914	0.58	
Five or more units	142	18,915	0.75	146	19,460	0.75	
Commercial real estate ...	2,709	162,169	1.67	2,935	164,604	1.78	
Construction	1,142	96,564	1.18	1,390	118,165	1.18	
Land	261	21,230	1.23	332	26,880	1.24	
Non-mortgage:							
Commercial	424	21,312	1.99	442	21,721	2.03	
Automobile	234	36,590	0.64	269	39,614	0.68	
Other consumer	677	58,610	1.16	727	60,653	1.20	
Not specifically allocated ..	2,800	--	--	2,800	--	--	
Total loans held for investment	$34,059	$9,833,371	0.35%	$34,452	$9,850,249	0.35%	$

	June 30, 2000			March 31, 2000		
Loans secured by real estate:						
Residential:						
One-to-four units	$14,622	$7,442,407	0.20%	$14,120	$6,961,984	0.20%
One-to-four units - subprime	9,862	1,695,352	0.58	9,036	1,699,956	0.53
Five or more units	175	19,900	0.88	178	20,292	0.88
Commercial real estate ...	2,690	147,752	1.82	2,634	148,920	1.77
Construction	1,433	121,602	1.18	1,747	147,910	1.18
Land	463	37,222	1.24	899	72,139	1.25
Non-mortgage:						
Commercial	283	24,511	1.15	293	26,922	1.09
Automobile	203	38,935	0.52	184	35,469	0.52
Other consumer	706	56,627	1.25	638	52,447	1.22
Not specifically allocated ..	2,800	--	--	2,800	--	--
Total loans held for investment	$33,237	$9,584,308	0.35%	$32,529	$9,166,039	0.35%

At March 31, 2001, the recorded investment in loans for which we recognized impairment totaled $14 million. The total allowance for losses related to these loans was $1 million. During the first quarter of 2001, total interest recognized on the impaired loan portfolio was $0.5 million.

A summary of the activity in the allowance for loan losses associated with impaired loans is shown below for the periods indicated. We have recorded provisions and reductions to the allowance associated with changes in the net book value of loans classified as impaired.

	Three Months Ended				
(In Thousands)	March 31, 2001	December 31, 2000	September 30, 2000	June 30, 2000	March 31, 2000
Balance at beginning of period	$ 800	$ 791	$ 792	$ 795	$ 797
Provision (reduction)	(2)	9	(1)	(3)	(2)
Charge-offs	--	--	--	--	--
Recoveries	--	--	--	--	--
Balance at end of period	$ 798	$ 800	$ 791	$ 792	$ 795

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

(In Thousands)	Three Months Ended March 31, 2001	December 31, 2000	September 30, 2000	June 30, 2000	March 31, 2000
Balance at beginning of period	$ 2,997	$ 2,961	$ 3,561	$ 2,088	$ 2,131
Provision (reduction)	33	36	(600)	1,473	(43)
Charge-offs	--	--	--	--	--
Recoveries	--	--	--	--	--
Balance at end of period	$ 3,030	$ 2,997	$ 2,961	$ 3,561	$ 2,088

CAPITAL RESOURCES AND LIQUIDITY

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

Our primary sources of funds generated in the first quarter of 2001 were from:

- a net increase in deposits of $626 million;
- principal repayments--including prepayments, but excluding refinances of our existing loans--on loans and mortgage-backed securities of $563 million; and
- maturities of U.S. Treasury securities, agency obligations and other investment securities available for sale of $203 million.

We used these funds for the following purposes:

- to originate loans held for investment of $522 million;
- to paydown our borrowings by $521 million;
- to increase our loans held for sale a net $195 million; and
- to purchase U.S. Treasury securities, agency obligations and other investment securities available for sale of $161 million.

At March 31, 2001, the Bank's ratio of regulatory liquidity was 4.6%, compared to 4.3% at December 31, 2000 and 4.0% at March 31, 2000.

Downey currently has liquid assets, including due from Bank--interest-bearing balances, of $18 million and can obtain further funds by means of dividends from subsidiaries, subject to certain limitations, or issuance of further debt or equity.

Stockholders' equity totaled $649 million at March 31, 2001, up from $625 million at December 31, 2000 and $557 million at March 31, 2000.

REGULATORY CAPITAL

The following table is a reconciliation of the Bank's stockholder's equity to federal regulatory capital as of March 31, 2001. Our core and tangible capital ratios were 6.55% and the risk-based capital ratio was 13.09%. The Bank's capital ratios exceed the "well capitalized" standards of 5.00% for core capital and 10.00% for risk-based capital, as defined by regulation.

	Tangible Capital		Core Capital		Risk-
(Dollars in Thousands)	Amount	Ratio	Amount	Ratio	Amou
Stockholder's equity	$745,486		$745,486		$745,
Adjustments:					
Deductions:					
Investment in subsidiary, primarily real estate	(17,818)		(17,818)		(17,
Goodwill	(3,493)		(3,493)		(3,
Non-permitted mortgage servicing rights	(3,572)		(3,572)		(3,
Additions:					
Unrealized gains on securities available for sale	(1,182)		(1,182)		(1,
General loss allowance - investment in DSL Service Company	516		516		
Allowance for loan losses, net of specific allowances (1)	--		--		33,
Regulatory capital	719,937	6.55%	719,937	6.55%	753,
Well capitalized requirement	164,944	1.50 (2)	549,812	5.00	575,
Excess	$554,993	5.05%	$170,125	1.55%	$178,

PART II -- OTHER INFORMATION

Item 6 - Exhibits and Reports on Form 8-K

(A) Exhibits.

(B) Form 8-K filed January 18, 2001.

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

DOWNEY FINANCIAL CORP.

Date: May 2, 2001

/s/ DANIEL D. ROSENTHAL

Daniel D. Rosenthal
President and Chief Executive Officer

Date: May 2, 2001

/s/ THOMAS E. PRINCE

Thomas E. Prince
Executive Vice President and Chief Financial Officer