COGNEX CORP
Form 4
August 14, 2013

FORM 4

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

OMB APPROVAL

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STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

(Print or Type Responses)

1. Name and Address of Reporting Person *
Willett Robert

(Last) (First) (Middle)

ONE VISION DRIVE

(Street)

NATICK, MA 01760

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
COGNEX CORP [CGNX]

3. Date of Earliest Transaction (Month/Day/Year)
08/14/2013

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

_____ Director _____ 10% Owner
__X__ Officer (give title below) _____ Other (specify below)
CEO& President

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock	08/14/2013		M		12,500	A	$ 17.76	12,500	D	
Common Stock	08/14/2013		S		12,500	D	$ 57.3225	0	D	

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amou Underlying Secur (Instr. 3 and 4)	
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Am or Nu of S
Non-Qualified Stock Option (right to buy)	$ 17.76	08/14/2013		M			12,500	06/11/2011	06/11/2020	Common Stock	12

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
Willett Robert ONE VISION DRIVE NATICK, MA 01760			CEO& President	

Signatures

Robert Willett	08/14/2013
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. serviced for others: Total .... $ 6,408,812 $ 5,805,811 $ 5,458,970 $ 5,056,120 $ 4,296,883 With capitalized mortgage servicing rights (1): Amount .... 6,196,137 5,379,513 5,078,088 4,456,822 3,999,380 Weighted average interest rate 6.85% 6.97% 7.19% 7.29% 7.50%
==
Custodial escrow balances .... $ 6,103 $ 10,596 $ 15,415 $ 9,924 $ 5,281
==
(1) The estimated fair value may exceed book value for certain asset strata and excluded loans sold or securitized prior to 1996 without capitalized mortgage servicing rights. Key assumptions, which vary due to changes in market interest rates and are used to determine the fair value of our mortgage servicing rights, include: expected prepayment speeds, which impact the average life of the portfolio; the earnings rate on custodial accounts, which impact the value of custodial accounts; and the discount rate used in valuing future cash flows. The table below summarizes the estimated changes in the fair value of our mortgage servicing rights for changes in those assumptions individually and in combination associated with an immediate 100 basis point increase or decrease in market rates. Also summarized is

the earnings impact associated with provisions to or reductions in the valuation allowance for mortgage servicing rights. Impairment is measured on a disaggregated basis based upon the predominant risk characteristics of the underlying mortgage loans such as term and coupon. Certain stratum may have impairment, while other stratum may not. Therefore, changes in overall fair value may not equal provisions to or reductions in the valuation allowance. 8 The sensitivity analysis in the table below is hypothetical and should be used with caution. As the figures indicate, changes in fair value based on a 100 basis point variation in assumptions generally cannot be easily extrapolated because the relationship of the change in the assumptions to the change in fair value may not be linear. Also, in this table, the effect that a change in a particular assumption may have on the fair value is calculated without changing any other assumption. In reality, changes in one factor may result in changes in another, which might magnify or counteract the sensitivities. Expected Value of Prepayment Custodial Discount (Dollars in Thousands) Speeds Accounts Rate Combination -- Increase rates 100 basis points: Fair value (1) .... $ 13,269 $ 4,010 $ (2,389) $ 13,920 Reduction of (increase in) valuation allowance ... 5,363 1,465 (909) 5,480 Decrease rates 100 basis points: Fair value (2) .... (17,660) (4,010) 2,541 (20,312) Reduction of (increase in) valuation allowance ... (15,711) (2,184) 728 (18,362) == (1) The weighted-average expected life is 117 months. (2) The weighted-average expected life is 53 months. The components of loan servicing income (loss) included in Downey's results of operations are summarized as follows: Three Months Ended -- March 31, December 31, September 30, June 30, March 31, (In Thousands) 2002 2001 2001 2001 2001 -- Income from servicing operations .... $ 2,688 $ 2,477 $ 2,576 $ 1,752 $ 2,223 Amortization of MSRs .... (2,916) (2,956) (2,495) (2,299) (2,063) (Provision for) reduction of impairment ... (360) 11,960 (11,852) (2,351) (8,345) -- Total loan servicing income (loss), net $ (588) $ 11,481 $(11,771) $ (2,898) $ (8,185) == NOTE (5) - ACCOUNTING FOR DERIVATIVES AND HEDGING ACTIVITIES Derivatives We offer short-term interest rate lock commitments to help us attract potential home loan borrowers. The commitments guarantee a specified interest rate for a loan if our underwriting standards are met, but do not obligate the potential borrower. The residential one-to-four unit interest rate lock commitments we ultimately expect to sell in the secondary market are treated as derivatives. Consequently, as derivatives, the hedging of the expected rate lock commitments do not qualify for hedge accounting. Associated fair value adjustments are recorded in current earnings under net gains on sales of loans and mortgage-backed securities with an offset to the balance sheet in either other assets, or accounts payable and accrued liabilities. Fair values for interest rate lock commitments are based on observable market prices acquired from third parties. The carrying amount of loans held for sale includes a basis adjustment to the loan at funding resulting from the change in the fair value of the interest rate lock derivative from the date of commitment to the date of funding. At March 31, 2002, we had rate lock commitments estimated to sell as part of our secondary marketing activities of $235 million, with an estimated fair value of $236 million, including a $2.7 million gain associated with mortgage servicing rights. Hedging Activities As part of our secondary marketing activities, we typically utilize short-term forward sale and purchase contracts--derivatives--that mature in less than one year to offset the impact of changes in market interest rates on the value of our residential one-to-four unit interest rate lock commitments and loans held for sale. We do not generally enter into derivative transactions for purely speculative purposes. Contracts designated to loans held for sale are accounted for as cash flow hedges because these contracts have a high correlation to the price movement of the loans being hedged (within a range of 80% - 125%). The measurement approach for determining the ineffective aspects of the hedge is established at the inception of the hedge. Changes in forward sale contract values not designated to loans held for sale and the ineffectiveness of hedge transactions that are not perfectly correlated are recorded in net gains on sales of loans and mortgage-backed securities. Changes in forward sale contract values designated as cash flow hedges for loans held for sale are recorded in other comprehensive income, net of tax, provided cash flow hedge requirements are met. The offset to these changes in forward 9 sale contract values are recorded in the balance sheet as either other assets, or accounts payable and accrued liabilities. 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 gains or losses in accumulated other comprehensive income will be reclassified into earnings within the next three months. Fair values for forward sale contracts are based on observable market prices acquired from third parties. At March 31, 2002, forward sale contracts amounted to $623 million, with an estimated fair value of $628 million, of which $392 million were designated as cash flow hedges, and there were no forward purchase contracts. We have not discontinued any designated derivative instruments associated with loans held for sale due to a change in the probability of settling a forecasted transaction. The following table contains the amount of expected rate lock commitment derivatives for loans originated for sale, loans held for sale and the notional amounts for their associated hedging derivatives (i.e., forward sale contracts). Also shown is the impact from non-qualifying hedges and the ineffectiveness of cash flow hedges on net gains (losses) on sales of loans and mortgage-backed securities (i.e., SFAS 133 effect), as well as the impact to other comprehensive income (loss) from qualifying cash flow transactions. March 31, December 31, September 30, June 30, March 31, (In Thousands) 2002 2001 2001 2001 2001
--- AT PERIOD END
Non-qualifying hedge transactions: Expected rate lock commitments .... $ 235,099 $ 269,315 $ 422,606 $ 264,397 $ 336,954 Associated forward sale contracts .... 230,660 278,319 404,177 294,284 399,720 Qualifying cash flow hedge transactions: Loans held for sale, at lower of cost or fair value 388,468 499,024 373,489 376,560 446,264 Associated forward sale contracts 392,099 508,706 369,335 358,378 371,798
===
THREE MONTHS ENDED Net gains (losses) on non-qualifying hedge transactions $ 4,864 $ (3,834) $ (1,149) $ 726 $ (1,707) Net gains (losses) on qualifying cash flow hedge transactions: Unrealized hedge ineffectiveness .... -- -- (27) 31 (471) Less reclassification of realized hedge ineffectiveness .... -- -- 27 21 419
--- Total net gains (losses) recognized in sales of loans and mortgage-backed securities (SFAS 133 effect) .... 4,864 (3,834) (1,149) 778 (1,759) Other comprehensive income (loss) 1,355 501 (2,477) 1,408 (159)
===
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 and 1997 tax years. Tax years subsequent to 1997 remain open to review by federal and state tax authorities. Downey's management believes it has adequately provided for potential exposure with regard to issues that may be raised in the years currently under examination and open to review. NOTE (7) - CURRENT ACCOUNTING ISSUES Statement of Financial Accounting Standards No. 142. SFAS 142 applies to all acquired intangible assets whether acquired singularly, as part of a group, or in a business combination. The Statement supersedes APB Opinion No. 17, "Intangible Assets," and carries forward provisions in Opinion 17 related to internally developed intangible assets. The Statement changes the accounting for goodwill from an amortization method to an impairment-only approach. Goodwill should no longer be amortized, but instead tested for impairment at least annually at the reporting unit level. The accounting provisions are effective for fiscal years beginning after December 31, 2001. Our intangible assets and goodwill are related to branch acquisitions and not within the scope of SFAS 142. However, this may change as the Financial Accounting Standards Board is currently reconsidering the exclusion of amortization of goodwill related to branch acquisitions and is expected to issue a final Statement in the fourth quarter of 2002. We recognized an unidentified intangible asset for branch acquisitions because the fair value of the liabilities assumed exceeded the fair value of the assets acquired. For the first quarter of 2002, our amortization of excess of cost over fair value of branch acquisitions was $0.1 million and as of March 31, 2002, this asset totaled $3.0 million. 10 Statement of Financial Accounting Standards No. 143. Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" ("SFAS 143"), addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. This Statement is effective for financial statements issued for fiscal years beginning after June 15, 2002. It is anticipated that the financial impact of this Statement will not have a material effect on Downey. Statement of Financial Accounting Standards No. 144. Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"), addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This Statement supersedes SFAS No. 121, "Accounting for the

Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of," and the accounting and reporting provisions of APB Opinion No. 30, "Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," for the disposal of a segment of a business. This Statement also eliminates the exception to consolidation for a subsidiary for which control is likely to be temporary. The provisions of this Statement are effective for financial statements issued for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years. The provisions of this Statement generally are to be applied prospectively. It is anticipated that the financial impact of this Statement will not have a material effect on Downey. 11 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 2002 totaled $37.3 million or $1.32 per share on a diluted basis, up 44.3% from the $25.9 million or $0.91 per share in the year-ago first quarter. The increase in net income between first quarters was due to higher net income from both of our business segments as follows: o Banking operations contributed $10.2 million to the increase in net income reflecting: o a $14.3 million increase in net gains from sales of loans and mortgage-backed securities, and mortgage servicing rights; o a $7.6 million improvement in our loan servicing activity primarily due to a smaller addition to the valuation allowance for mortgage servicing rights; o a $3.8 million increase in net interest income due to an increase in our effective interest rate spread; and o a $1.3 million increase in loan and deposit related fees. Those favorable items were partially offset by: o an $8.0 million increase in operating expenses reflecting an increased number of branch locations and higher loan origination activity; and o a $1.4 million increase in provision for loan losses. o Real estate investment activities contributed $1.2 million to the increase in net income reflecting: o a recapture of $1.3 million of a previously established valuation allowance; and o an increase of $0.3 million in net gains to a total of $0.6 million. In addition to higher net income, our key performance measures also improved between first quarters as follows: o our efficiency ratio (the percentage of our net interest income and other income, excluding income from real estate investment activities and investment securities gains or losses, used to cover our general and administrative expense) improved from 45.8% to 41.8%; o our return on average assets improved from 0.94% to 1.36%; and o our return on average equity improved from 16.28% to 19.96%. Our single family loan originations totaled $2.259 billion in the first quarter of 2002, up 57.1% from the $1.438 billion we originated in the first quarter of 2001 but down 9.6% from the record $2.500 billion we originated in the previous quarter. Of the current quarter total, $992 million represented originations of loans for portfolio, of which $107 million represented subprime credits. In addition to single family loans, we originated $46 million of other loans in the quarter. At quarter-end, our assets totaled $10.9 billion and our deposits totaled $8.6 billion, both of which were down slightly from a year ago. During the quarter, six new in-store branches and one new traditional branch were opened, bringing our total branches at quarter end to 144, of which 74 are in-store. A year ago, branches totaled 121, of which 56 were in-store. Our non-performing assets increased $1 million during the quarter to $94 million or 0.86% of total assets. This increase was due to a rise in commercial real estate non-accrual loans of $2 million due primarily to a shopping center loan whose principal tenant declared bankruptcy during the quarter and ceased paying rent. 12 At March 31, 2002, our primary subsidiary, Downey Savings and Loan Association, F.A. (the "Bank") exceeded all regulatory capital tests, with capital-to-asset ratios of 7.61% for both tangible and core capital and 15.39% for risk-based capital. These capital levels are significantly above the "well capitalized" standards defined by the federal banking regulators of 5% for core and tangible capital and 10% for risk-based capital. We have established various accounting policies which govern the application of accounting principles generally accepted in the United States of America in the preparation of our financial statements. Our significant accounting policies are described in Downey's Annual Report on Form 10-K for the year ended December 31, 2001. Certain accounting policies require us to make significant estimates and assumptions which have a material impact on the carrying value of certain assets and liabilities, and we consider these to be critical accounting policies. The estimates and assumptions we use are based on historical experience and other factors, which we believe to be reasonable under the circumstances. Actual results could differ significantly from these estimates and assumptions which could have a material impact on the carrying value of assets and liabilities at the balance sheet dates and our

results of operations for the reporting periods. We believe the following are critical accounting policies that require the most significant estimates and assumptions that are particularly susceptible to significant change in the preparation of our financial statements: o Allowance for losses on loans and real estate. For further information, see Financial Condition--Problem Loans and Real Estate--Allowance for Losses on Loans and Real Estate on page 31. o Allowance for mortgage servicing rights. For further information, see Note 4 on page 8 of Notes to Consolidated Financial Statements. 13 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 $79.9 million in the first quarter of 2002, up $3.8 million or 5.0% from the same period last year. The improvement between first quarters reflected an increase in our effective interest rate spread, which averaged 3.03% compared to 2.87% a year ago. The improvement between first quarters was due to our cost of funds declining more rapidly than our yield on earning assets. This is indicative of what typically happens when interest rates decline, as there is an administrative lag in the repricing of our loans which are primarily priced to the Federal Home Loan Bank ("FHLB") Eleventh District Cost of Funds Index ("COFI"). Our earning assets averaged $10.5 billion during the quarter, slightly below the year-ago level. The following table presents for the periods indicated the total dollar amount of: o interest income from average interest-earning assets and the resultant yields; and o 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: o the difference between interest income on interest-earning assets and interest expense on interest-bearing liabilities, divided by o 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. 14 Three Months Ended
-- March 31, 2002 December 31, 2001
March 31, 2001 -- Average Average
Average Average Yield/ Average Yield/ Average Yield/ (Dollars in Thousands) Balance Interest Rate Balance Interest Rate Balance Interest Rate
----
Interest-earning assets: Loans .... $ 9,973,808 $160,277 6.43% $10,000,631 $178,335 7.13% $10,180,942 $212,762 8.36% Mortgage-backed securities .... 106,375 1,274 4.79 36,623 449 4.90 7,761 128 6.60 Investment securities 464,447 4,847 4.23 420,718 4,700 4.43 431,023 7,076 6.66
-- Total interest-earning assets 10,544,630 166,398 6.31 10,457,972 183,484 7.02 10,619,726 219,966 8.29 Non-interest-earning assets 398,488 370,537 353,887
-- Total assets $10,943,118 $10,828,509 $10,973,613
==
Transaction accounts: Non-interest-bearing checking . $ 285,156 $ -- -- % $ 354,231 $ -- -- % $ 246,246 $ -- -- % Interest-bearing checking (1) . 425,162 413 0.39 414,470 424 0.41 396,484 633 0.65 Money market .... 110,715 507 1.86 103,247 533 2.05 89,259 626 2.84 Regular passbook 2,442,994 15,394 2.56 1,646,412 11,184 2.70 766,948 6,427 3.40
-- Total transaction accounts .. 3,264,027 16,314 2.03 2,518,360 12,141 1.91 1,498,937 7,686 2.08 Certificates of deposit 5,259,181 52,045 4.01 6,214,429 76,494 4.88 6,873,614 107,115 6.32
-- Total deposits .... 8,523,208 68,359 3.25 8,732,789 88,635 4.03 8,372,551 114,801 5.56 Borrowings ....

1,425,878 15,053 4.28 1,114,446 12,093 4.31 1,716,077 25,962 6.14 Capital securities .... 120,000 3,041 10.14 120,000 3,041 10.14 120,000 3,041 10.14 -- Total deposits, borrowings and capital securities .... 10,069,086 86,453 3.48 9,967,235 103,769 4.13 10,208,628 143,804 5.71 Other liabilities .... 126,079 150,070 129,588 Stockholders' equity .... 747,953 711,204 635,397 -- Total liabilities and stockholders' equity .... $10,943,118 $10,828,509 $10,973,613 == Net interest income/interest rate spread .... $ 79,945 2.83% $ 79,715 2.89% $ 76,162 2.58% Excess of interest-earning assets over deposits, borrowings and capital securities .... $ 475,544 $ 490,737 $ 411,098 Effective interest rate spread .... 3.03 3.05 2.87 == (1) Included amounts swept into money market deposit accounts. 15 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: o changes in volume--changes in volume multiplied by comparative period rate; o changes in rate--changes in rate multiplied by comparative period volume; and o 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, 2002 Versus March 31, 2001 Changes Due To -- Rate/ (In Thousands) Volume Rate Volume Net --- Interest income: Loans .... $ (4,329) $(49,156) $ 1,000 $(52,485) Mortgage-backed securities ...... 1,626 (35) (445) 1,146 Investment securities .... 549 (2,578) (200) (2,229) --- Change in interest income ..... (2,154) (51,769) 355 (53,568) --- Interest expense: Transaction accounts: Interest-bearing checking (1) . 46 (248) (18) (220) Money market .... 150 (217) (52) (119) Regular passbook .... 14,045 (1,594) (3,484) 8,967 --- Total transaction accounts .. 14,241 (2,059) (3,554) 8,628 Certificates of deposit .... (25,159) (39,093) 9,182 (55,070) --- Total interest-bearing deposits (10,918) (41,152) 5,628 (46,442) Borrowings .... (4,406) (7,180) 677 (10,909) Capital securities .... -- -- -- -- --- Change in interest expense .... (15,324) (48,332) 6,305 (57,351) --- Change in net interest income .... $ 13,170 $ (3,437) $ (5,950) $ 3,783 == (1) Included amounts swept into money market deposit accounts. PROVISION FOR LOAN LOSSES Provision for loan losses was $1.4 million in the current quarter, up from $0.1 million in the first quarter of 2001. For further 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 31. OTHER INCOME Our total other income was $31.4 million in the first quarter of 2002, up $25.3 million from a year ago reflecting: o a $14.3 million increase in net gains on sales of loans and mortgage-backed securities, and mortgage servicing rights; o a $7.6 million improvement in our loan servicing activity primarily due to a smaller addition to the valuation allowance for mortgage servicing rights; o a $2.0 million increase from real estate held for investment due primarily to sales activity; and o a $1.3 million increase in loan and deposit related fees. 16 LOAN AND DEPOSIT RELATED FEES Loan and deposit related fees totaled $11.5 million in the first quarter of 2002, up $1.3 million from a year ago. Our deposit related fees increased by $0.7 million or 18.8%, primarily due to higher fees from our checking accounts. Our loan related fees accounted for $0.6 million of the increase between first quarters, of which $0.2 million represented higher loan prepayment fees. The following table presents a breakdown of loan and deposit related fees during the periods indicated. Three Months Ended -- March 31, December 31, September 30, June 30, March 31, (In Thousands) 2002 2001 2001 2001 2001

-- Loan related fees: Prepayment fees .... $ 4,686 $ 5,475 $ 6,384 $ 7,455 $ 4,525 Other fees .... 2,167 2,477 2,257 2,251 1,779 Deposit related fees: Automated teller machine fees .... 1,543 1,670 1,671 1,650 1,533 Other fees .... 3,122 3,224 2,962 2,780 2,393 -- Total loan and deposit related fees $11,518 $12,846 $13,274 $14,136 $10,230 ==

REAL ESTATE AND JOINT VENTURES HELD FOR INVESTMENT Income from our real estate and joint ventures held for investment totaled $3.0 million in the first quarter of 2002, up from $1.0 million a year ago. The $2.0 million increase in our income from real estate held for investment was due primarily to sales activity. Sales in the first quarter of 2002 resulted in the recapture of $1.3 million of a previously established valuation allowance and an increase of $0.3 million in net gains to a total of $0.6 million. Those gains primarily relate to joint venture projects and are reported in the category of equity in net income from joint ventures. 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 --- March 31, December 31, September 30, June 30, March 31, (In Thousands) 2002 2001 2001 2001 2001 -- Rental operations, net of expenses .... $ 823 $ 1,026 $ 259 $ 452 $ 508 Equity in net income from joint ventures .... 745 212 12 121 391 Interest from joint venture advances .... 111 83 101 152 132 Net gains on sales of wholly owned real estate .... -- 127 -- -- 2 (Provision for) reduction of losses on real estate and joint ventures .... 1,318 (1) 374 (33) (33) -- Income from real estate and joint ventures held for investment, net .... $ 2,997 $ 1,447 $ 746 $ 692 $ 1,000 ==

SECONDARY MARKETING ACTIVITIES Sales of loans and mortgage-backed securities we originated increased in the first quarter of 2002 to $1.381 billion from $597 million a year ago. Net gains associated with these sales totaled $16.2 million in the first quarter of 2002, up from $2.1 million a year ago. Net gains included the capitalization of mortgage servicing rights of $15.0 million in the first quarter of 2002, compared to $5.4 million a year ago. A loss of $0.6 million was recorded in loan servicing from our portfolio of loans serviced for others during the first quarter of 2002, an improvement from a loss of $8.2 million in the year-ago period. This $7.6 million improvement primarily reflected a smaller addition to the valuation allowance for mortgage servicing rights, $0.4 million in the current quarter compared to $8.3 million a year ago. At March 31, 2002, we serviced $6.4 billion of loans for others compared to $5.8 billion at December 31, 2001 and $4.3 billion at March 31, 2001. 17 The following table presents a breakdown of the components of our loan servicing income (loss) for the periods indicated. Three Months Ended -- March 31, December 31, September 30, June 30, March 31, (In Thousands) 2002 2001 2001 2001 2001 -- Income from servicing operations .... $ 2,688 $ 2,477 $ 2,576 $ 1,752 $ 2,223 Amortization of MSRs .... (2,916) (2,956) (2,495) (2,299) (2,063) (Provision for) reduction of impairment ... (360) 11,960 (11,852) (2,351) (8,345) -- Total loan servicing income (loss), net $ (588) $ 11,481 $(11,771) $ (2,898) $ (8,185) ==

For further information regarding mortgage servicing rights, see Notes To Consolidated Financial Statements--Note (4)--Mortgage Servicing Rights on page 8. OPERATING EXPENSE Our operating expense totaled $45.2 million in the current quarter, up $8.0 million or 21.4% from the first quarter of 2001 because of higher general and administrative expense. That increase was primarily due to higher costs associated with an increased number of branch locations and higher loan origination activity. The following table presents a breakdown of key components comprising operating expense during the periods indicated. Three Months Ended -- March 31, December 31, September 30, June 30, March 31, (In Thousands) 2002 2001 2001 2001 2001 -- Salaries and related costs

.... $ 29,437 $ 27,075 $ 24,943 $ 24,646 $ 23,271 Premises and equipment costs .... 7,133 7,303 6,628 6,042 6,043 Advertising expense .... 1,044 1,168 939 1,127 1,176 Professional fees .... 564 839 2,432 1,604 577 SAIF insurance premiums and regulatory assessments .... 786 792 786 741 732 Other general and administrative expense ..... 6,211 6,339 5,981 5,973 5,339 -- Total general and administrative expense .. 45,175 43,516 41,709 40,133 37,138 Net operation of real estate acquired in settlement of loans .... (58) 237 110 (106) (2) Amortization of excess of cost over fair value of branch acquisitions .... 111 113 116 114 114 -- Total operating expense .... $ 45,228 $ 43,866 $ 41,935 $ 40,141 $ 37,250 ==

PROVISION FOR INCOME TAXES Income taxes for the first quarter totaled $27.3 million, resulting in an effective tax rate of 42.3%, compared to $19.0 million and 42.4% 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 10. 18 BUSINESS SEGMENT REPORTING The previous sections of the Results of Operations discussed our consolidated results. The purpose of this section is to present data and discussion 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. Three Months Ended --- March 31, December 31, September 30, June 30, March 31, (In Thousands) 2002 2001 2001 2001 2001 -- Banking net income .... $ 35,557 $ 38,225 $ 22,301 $ 33,619 $ 25,309 Real estate investment net income (loss) 1,757 871 (535) (164) 555 -- Total net income .... $ 37,314 $ 39,096 $ 21,766 $ 33,455 $ 25,864 ==

Banking Net income from our banking operations for the first quarter of 2002 totaled $35.6 million, up $10.2 million or 40.5% from $25.3 million in the first quarter of 2001. The increase between first quarters primarily reflected the following: o a $14.3 million increase in net gains from sales of loans and mortgage-backed securities, and mortgage servicing rights; o a $7.6 million improvement in our loan servicing activity primarily due to a smaller addition to the valuation allowance for mortgage servicing rights, $0.4 million in the current quarter compared to $8.3 million a year ago; o a $3.8 million increase in net interest income due to an increase in our effective interest rate spread; and o a $1.3 million increase in loan and deposit related fees. Those favorable items were partially offset by the following: o an $8.0 million increase in operating expenses reflecting an increased number of branch locations and higher loan origination activity; and o a $1.4 million increase in provision for loan losses due primarily to a commercial real estate loan that became impaired during the quarter. 19 The table below sets forth our banking operational results and selected financial data for the periods indicated. Three Months Ended --- March 31, December 31, September 30, June 30, March 31, (In Thousands) 2002 2001 2001 2001 2001 -- Net interest income .... $ 79,940 $ 79,730 $ 73,473 $ 76,236 $ 76,134 Provision for loan losses .... 1,447 1,290 791 431 52 Other income .... 28,062 31,397 5,987 21,211 4,745 Operating expense .... 45,006 43,680 40,071 38,863 36,990 Net intercompany income .... 93 96 92 84 97 -- Income before income taxes .... 61,642 66,253 38,690 58,237 43,934 Income taxes .... 26,085 28,028 16,389 24,618 18,625 -- Net income .... $ 35,557 $ 38,225 $ 22,301 $ 33,619 $ 25,309 ==

AT PERIOD END Assets: Loans and mortgage-backed securities $10,088,113 $10,132,413 $ 9,912,489 $ 9,981,213 $10,272,222 Other .... 819,407 966,942 797,775 837,387 755,324 -- Total assets ....

10,907,520 11,099,355 10,710,264 10,818,600 11,027,546
-- Equity ....
$ 767,622 $ 733,896 $ 698,475 $ 680,719 $ 648,592
==

Real Estate Investment Net income from our real estate investment operations totaled $1.8 million in the first quarter of 2002, up from $0.6 million in the year-ago quarter. The increase was primarily attributed to higher sales activity that resulted in the recapture of $1.3 million of a previously established valuation allowance and an increase of $0.3 million in net gains that totaled $0.6 million in the current quarter. The table below sets forth real estate investment operational results and selected financial data for the periods indicated. Three Months Ended
--- March 31, December 31, September 30, June 30, March 31, (In Thousands) 2002 2001 2001 2001 2001
-- Net interest income (loss)
.... $ 5 $ (15) $ (26) $ 10 $ 28 Other income .... 3,291 1,773 1,083 1,072 1,268 Operating expense .... 222 186 1,864 1,278 260 Net intercompany expense 93 96 92 84 97
-- Income (loss) before income taxes (benefit) ... 2,981 1,476 (899) (280) 939 Income taxes (benefit) 1,224 605 (364) (116) 384
-- Net income (loss)
.... $ 1,757 $ 871 $ (535) $ (164) $ 555
==
AT PERIOD END Assets: Investment in real estate and joint ventures $26,384 $38,185 $38,043 $19,950 $18,690 Other 4,060 2,003 1,629 1,673 3,337
-- Total assets
.... 30,444 40,188 39,672 21,623 22,027
-- Equity
.... $24,963 $34,513 $33,642 $18,307 $18,471
==

Our investment in real estate and joint ventures amounted to $26 million at March 31, 2002, compared to $38 million at December 31, 2001 and $19 million at March 31, 2001. 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 31. 20 FINANCIAL CONDITION LOANS AND MORTGAGE-BACKED SECURITIES Total loans and mortgage-backed securities, including those we hold for sale, declined $44 million during the first quarter to a total of $10.1 billion or 92.4% of assets at March 31, 2002. The decrease represented a lower level of loans held for sale and mortgage-backed securities available for sale, as loans held for investment increased by $94 million. Given the low interest rate environment and borrower preference for fixed rate loans, our annualized prepayment speed in the current quarter was 39%, compared to 27% a year ago and 37% during the previous quarter. The following table sets forth loans originated, including purchases, for investment and for sale during the periods indicated. Three Months Ended --- March 31, December 31, September 30, June 30, March 31, (In Thousands) 2002 2001 2001 2001 2001
-- Loans originated for investment: Residential one-to-four units: Adjustable .... $ 988,063 $ 884,312 $ 867,271 $ 814,696 $ 636,988 Fixed .... 4,366 1,788 4,445 10,849 4,117 Other .... 45,752 51,488 56,554 43,492 28,964 -- Total loans originated for investment 1,038,181 937,588 928,270 869,037 670,069 Loans originated for sale (1) 1,266,430 1,613,671 1,116,589 1,296,877 796,801
-- Total loans originated
.... $2,304,611 $2,551,259 $2,044,859 $2,165,914 $1,466,870
==

(1) Residential one-to-four unit loans, primarily fixed. Originations of one-to-four unit residential loans totaled $2.259 billion in the first quarter of 2002, of which $992 million or 44% were for portfolio, with the balance for sale in the secondary market. This was 9.6% below the $2.500 billion originated in the fourth quarter of 2001, but 57.1% higher than the $1.438 billion we originated in the year-ago first quarter. Of the current quarter originations for portfolio,

$107 million represented originations of subprime credits as part of our continuing strategy to enhance the portfolio's net yield. During the current quarter, 80% of our residential one-to-four unit originations represented refinancing transactions. This is down from 82% in the previous quarter, but up from 71% in the year-ago first quarter. In addition to single family loans, we originated $46 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 behind the movement in market interest rates. This experience is similar to that of recent quarters. Our adjustable rate mortgages: o 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; o generally 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 o limit interest rate adjustments, for loans that adjust both the interest rate and payment amount simultaneously, 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 the interest rate monthly and the payment annually. These monthly adjustable rate mortgages: o have a lifetime interest rate cap, but no specified periodic interest rate adjustment cap; o have a periodic cap on changes in required monthly payments; and o allow for negative amortization, which is the addition to loan principal of accrued interest that exceeds the required monthly loan payments. 21 If a loan incurs significant negative amortization, the loan-to-value ratio could increase which indicates an increased risk that the fair value of the underlying collateral on the loan would be insufficient to satisfy fully the outstanding principal and interest. A loan-to-value ratio is the ratio of the principal amount of the loan to the lower of the sales price or appraised value of the property securing the loan at origination. We currently impose a limit on the amount of negative amortization. The principal plus the added amount cannot exceed 125% of the original loan amount, except for subprime loans and loans with loan-to-value ratios of 80% or greater wherein the borrower has obtained private mortgage insurance to reduce the effective loan-to-value ratio to between 70% and 78%. In those two instances, the principal plus negative amortization cannot exceed 110% of the original loan amount. At March 31, 2002, $6.7 billion of the adjustable rate mortgages in our loan portfolio were subject to negative amortization, of which $166 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 $1.381 billion of loans in the first quarter of 2002, compared to $1.472 billion in the previous quarter and $597 million in the first quarter of 2001. All were secured by residential one-to-four unit property, and at March 31, 2002, loans held for sale totaled $388 million. At March 31, 2002, our unfunded loan application pipeline totaled $1.3 billion. Within that pipeline, we had commitments to borrowers for short-term interest rate locks of $660 million, of which $289 million were related to residential one-to-four unit loans being originated for sale in the secondary market. Furthermore, we had commitments on undrawn lines and letters of credit of $89 million and loans in process of $56 million. We believe our current sources of funds will enable us to meet these obligations. 22 The following table sets forth the origination, purchase and sale activity relating to our loans and mortgage-backed securities during the periods indicated. Three Months Ended -- March 31, December 31, September 30, June 30, March 31, (In Thousands) 2002 2001 2001 2001 2001 -- INVESTMENT PORTFOLIO Loans originated: Loans secured by real estate: Residential one-to-four units: Adjustable .... $ 880,729 $ 801,751 $ 767,246 $ 620,539 $ 501,945 Adjustable - subprime .... 107,334 82,561 100,025 106,148 135,043 -- Total adjustable .... 988,063 884,312 867,271 726,687 636,988 Fixed .... 4,336 1,577 3,294 7,455 4,117 Fixed - subprime .... -- 211 1,103 3,394 -- Residential five or more units: Adjustable .... -- -- -- -- -- Fixed .... -- -- -- 125 -- -- Total residential .... 992,399 886,100 871,668 737,661 641,105 Commercial real estate .... -- 133 -- -- -- Construction .... 13,672 32,025 27,649 23,154 18,888 Land .... 18,542 5,153 4,870 6,219 -- Non-mortgage: Commercial .... 1,361 4,006 8,440 4,970 165 Automobile .... 376 275 957 1,502 2,091 Other consumer 11,801 9,896 7,965 7,522 7,570

-- Total loans originated .... 1,038,151 937,588 921,549 781,028 669,819 Real estate loans purchased: One-to-four units .... 30 -- 48 88,009 -- One-to-four units - subprime .... -- -- -- -- -- Other (1) .... -- -- 6,673 -- 250
-- Total real estate loans purchased .... 30 -- 6,721 88,009 250
-- Total loans originated and purchased .... 1,038,181 937,588 928,270 869,037 670,069 Loan repayments .... (942,811) (945,582) (968,918) (1,095,547) (705,116) Other net changes (2) .... (936) (12,036) (24,333) 5,813 32,585
-- Net increase (decrease) in loans held for investment .. 94,434 (20,030) (64,981) (220,697) (2,462)
-- SALE PORTFOLIO Residential one-to-four units: Originated whole loans .... 1,264,559 1,610,470 1,115,345 1,296,270 796,216 Loans purchased .... 1,871 3,201 1,244 607 585 Loans transferred to the investment portfolio .... (614) (3,167) (1,108) (787) (2,392) Originated whole loans sold .... (156,206) (181,632) (129,237) (292,552) (134,352) Loans exchanged for mortgage-backed securities .... (1,225,243) (1,290,355) (991,232) (1,071,840) (462,744) Other net changes .... (789) (404) (530) (649) (3,179) Capitalized basis adjustment (3) 5,866 (12,578) 2,447 (753) 558
-- Net increase (decrease) in loans held for sale ...... (110,556) 125,535 (3,071) (69,704) 194,692
-- Mortgage-backed securities, net: Received in exchange for loans .... 1,225,243 1,290,355 991,232 1,071,840 462,744 Sold .... (1,225,243) (1,290,355) (991,232) (1,071,840) (462,744) Purchased .... -- 115,597 -- -- -- Repayments .... (26,553) (773) (686) (647) (4,417) Other net changes .... (1,625) (405) 14 39 56
-- Net increase (decrease) in mortgage-backed securities available for sale .... (28,178) 114,419 (672) (608) (4,361) -- Net increase (decrease) in loans held for sale and mortgage-backed securities available for sale ...... (138,734) 239,954 (3,743) (70,312) 190,331
-- Total net increase (decrease) in loans and mortgage-backed securities .... $ (44,300) $ 219,924 $ (68,724) $ (291,009) $ 187,869
==
(1) Included one commercial loan for the three months ended September 30, 2001 and two residential five or more unit loans for the three months ended March 31, 2001. (2) Primarily included borrowings against and repayments of lines of credit and construction loans, changes in loss allowances, loans transferred to real estate acquired in settlement of loans or from (to) the held for sale portfolio, and the change in interest capitalized on loans (negative amortization). (3) Reflected the change in fair value from date of interest rate lock commitment to date of origination. 23 The following table sets forth the composition of our loan and mortgage-backed securities portfolio at the dates indicated. March 31, December 31, September 30, June 30, March 31, (In Thousands) 2002 2001 2001 2001 2001
-- INVESTMENT PORTFOLIO Loans secured by real estate: Residential one-to-four units: Adjustable .... $ 7,574,205 $ 7,364,677 $ 7,191,929 $ 7,097,270 $ 7,215,128 Adjustable - subprime .... 1,423,661 1,491,416 1,588,573 1,683,302 1,748,715 Fixed .... 295,228 334,384 375,533 408,757 437,197 Fixed - subprime 13,099 15,303 17,421 18,256 16,941
-- Total residential one-to-four units .... 9,306,193 9,205,780 9,173,456 9,207,585 9,417,981 Residential five or more units: Adjustable .... 5,920 6,055 6,199 13,359 13,462 Fixed .... 4,230 5,124 5,290 5,464 5,453 Commercial real estate: Adjustable .... 40,650 40,900 41,987 47,236 47,583 Fixed

.... 69,691 71,609 100,493 110,513 114,586 Construction .... 78,202 84,942 99,161 99,261 96,564 Land .... 36,303 22,028 21,121 21,283 21,230 Non-mortgage: Commercial .... 21,182 22,017 22,762 21,648 21,312 Automobile .... 20,902 24,529 29,109 32,594 36,590 Other consumer .... 48,067 50,908 53,243 56,096 58,610 --- Total loans held for investment .... 9,631,340 9,533,892 9,552,821 9,615,039 9,833,371 Increase (decrease) for: Undisbursed loan funds .... (65,813) (61,280) (62,880) (59,940) (59,206) Net deferred costs and premiums .... 80,622 77,916 79,540 78,621 80,010 Allowance for losses .... (37,307) (36,120) (35,043) (34,301) (34,059) --- Total loans held for investment, net .... 9,608,842 9,514,408 9,534,438 9,599,419 9,820,116 --- SALE PORTFOLIO, NET Loans held for sale: Residential one-to-four units .... 392,928 509,317 371,237 376,755 445,706 Residential one-to-four units - subprime .... -- 33 -- -- -- Capitalized basis adjustment (1) .... (4,460) (10,326) 2,252 (195) 558 --- Total loans held for sale .... 388,468 499,024 373,489 376,560 446,264 Mortgage-backed securities available for sale: Adjustable .... 73,792 101,562 4,562 5,234 5,835 Fixed .... 17,011 17,419 -- -- 7 --- Total mortgage-backed securities available for sale .... 90,803 118,981 4,562 5,234 5,842 --- Total loans held for sale and mortgage-backed securities available for sale .... 479,271 618,005 378,051 381,794 452,106 --- Total loans and mortgage-backed securities ... $ 10,088,113 $ 10,132,413 $ 9,912,489 $ 9,981,213 $ 10,272,222 === (1) Reflected the change in fair value from date of interest rate lock commitment to date of origination. We carry loans for sale at the lower of cost or fair value. At March 31, 2002, no valuation allowance was required as the fair value exceeded book value on an aggregate basis. At March 31, 2002, our residential one-to-four units subprime portfolio consisted of approximately 80% "A-" credit, 17% "B" credit and 3% "C" credit loans. At March 31, 2002, 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, 2002, reflected an unrealized loss of $2.9 million. The current quarter-end unrealized loss, less the associated tax effect, is reflected within a separate component of other comprehensive income (loss) until realized. 24 DEPOSITS At March 31, 2002, our deposits totaled $8.6 billion, down slightly from both the year-ago level and year-end 2001. Compared to the year-ago period, our certificates of deposit declined $2.1 billion or 29.9%, which was partially offset by an increase in our lower-rate transaction accounts--i.e., checking, regular passbook and money market--of $2.0 billion, more than double the year-ago level. Within transaction accounts, approximately 99% of the increase was in our passbook accounts, as depositors moved monies from certificates of deposit because they seemed more interested in liquidity given the relatively low level of interest rates. At March 31, 2002, the average deposit size of our traditional branches was $105 million, while the average size of our in-store branches was $17 million, or $21 million excluding the 18 new in-store branches opened within the past 12 months. The following table sets forth information concerning our deposits and weighted average rates paid at the dates indicated. March 31, 2002 December 31, 2001 September 30, 2001 June 30, 2001 March 31, 2001 -- Weighted Weighted Weighted Weighted Weighted Average Average Average Average Average (Dollars in Thousands) Rate Amount Rate Amount Rate Amount Rate Amount Rate Amount -- Transaction accounts: Non-interest-bearing checking .... -- % $ 312,962 -- % $ 263,165 -- % $ 327,335 -- % $ 328,338 -- % $ 335,404 Interest-bearing checking (1) ...... 0.25 436,612 0.35 423,776 0.42 403,134 0.42 401,126 0.42 416,636 Money market .... 1.82 112,646 2.01 108,747 2.29 97,548 2.79 89,949 2.87 91,733 Regular passbook ... 2.57 2,789,500 2.46 2,131,048 2.96 1,308,959 3.44 986,488 3.38 807,503

--- Total transaction accounts .... 2.05 3,651,720 1.92 2,926,736 2.00 2,136,976 2.11 1,805,901 1.92 1,651,276 Certificates of deposit: Less than 3.00% ..... 2.45 1,467,532 2.41 970,854 2.41 39,217 2.48 27,473 2.14 7,620 3.00-3.49 .... 3.29 1,080,673 3.20 458,511 3.26 379,901 3.36 8,342 3.45 26 3.50-3.99 .... 3.84 527,613 3.84 532,634 3.83 508,383 3.83 82,191 3.81 20,748 4.00-4.49 .... 4.23 830,142 4.22 892,517 4.22 888,123 4.29 387,442 4.38 7,279 4.50-4.99 .... 4.76 495,530 4.76 555,885 4.73 815,711 4.74 691,800 4.72 293,442 5.00-5.99 .... 5.21 356,605 5.30 921,510 5.36 1,883,498 5.50 2,791,697 5.62 2,288,745 6.00 and greater 6.32 189,075 6.37 1,360,919 6.46 2,216,973 6.59 3,245,218 6.64 4,439,139
--- Total certificates of deposit 3.66 4,947,170 4.54 5,692,830 5.24 6,731,806 5.82 7,234,163 6.21 7,056,999
--- Total deposits .. 2.98% $8,598,890 3.65% $8,619,566 4.46% $8,868,782 5.08% $9,040,064 5.40% $8,708,275
===

(1) Included amounts swept into money market deposit accounts. BORROWINGS During the current quarter, our borrowings declined $202 million to $1.3 billion, due to a decrease in FHLB advances. This followed an increase of $595 million during the fourth quarter of 2001. The following table sets forth information concerning our FHLB advances and other borrowings at the dates indicated. March 31, December 31, September 30, June 30, March 31, (Dollars in Thousands) 2002 2001 2001 2001 2001
--- Federal Home Loan Bank advances .... $1,320,386 $1,522,705 $ 927,398 $ 892,670 $1,457,046 Other borrowings .... -- 7 29 94 145
--- Total borrowings .... $1,320,386 $1,522,712 $ 927,427 $ 892,764 $1,457,191
--- Weighted average rate on borrowings during the period .... 4.28% 4.31% 5.01% 5.67% 6.14% Total borrowings as a percentage of total assets 12.10 13.71 8.65 8.25 13.21
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25 CAPITAL SECURITIES On July 23, 1999, we issued $120 million in capital securities through Downey Financial Capital Trust I. 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 on our capital securities, including the amortization of deferred issuance costs, was $3.0 million for the first quarter of 2002. 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 primarily 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. In addition to the market risk associated with our lending and deposit taking activities, we also have market risk associated with our secondary marketing activities. Changes in mortgage interest rates, primarily fixed rate mortgages, impact the fair value of loans held for sale as well as our off-balance sheet commitments where we have committed to an interest rate with a potential borrower for a loan we intend to sell (known as an interest rate lock derivative). Our objective is to hedge against fluctuations in interest rates through use of forward sale and purchase contracts with government-sponsored enterprises and whole loan sale contracts with various parties. These contracts are typically obtained at the time the interest rate lock commitments are made. Therefore, as interest rates fluctuate, the changes in the fair value of our interest rate lock commitments and loans held for sale tend to be offset by changes in the fair value of the hedge contracts. 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 the overall economics of the transactions. Changes

in mortgage interest rates also impact the value of our mortgage servicing rights. Rising interest rates typically result in slower prepayment speeds on the loans being serviced for others which increase the value of mortgage servicing rights. Declining interest rates typically result in faster prepayment speeds which decrease the value of mortgage servicing rights. Currently, we do not hedge our mortgage servicing rights against that risk. We currently do not enter into hedging contracts for speculative purposes. There has been no significant change in our market risk since December 31, 2001. 26 One measure of our exposure to differential changes in interest rates between assets and liabilities is shown in the following table which sets forth the repricing frequency of our major asset and liability categories as of March 31, 2002, 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 set forth. March 31, 2002 -- Within 7 - 12 1 - 5 6 - 10 Over Total (Dollars in Thousands) 6 Months Months Years Years 10 Years Balance -- Interest-earning assets: Investment securities and FHLB stock ..(1) $ 264,684 $ 17,893 $ 125,707 $ 68 $ -- $ 408,352 Loans and mortgage-backed securities: (2) Loans secured by real estate: Residential: Adjustable .... 7,671,717 192,364 1,191,558 -- -- 9,055,639 Fixed .... 429,818 33,307 154,616 61,581 21,417 700,739 Commercial real estate .... 39,457 11,508 50,708 2,234 1,584 105,491 Construction .... 38,205 -- -- -- -- 38,205 Land .... 17,492 9 66 781 -- 18,348 Non-mortgage loans: Commercial .... 10,805 -- -- -- -- 10,805 Consumer .... 52,568 4,415 11,100 -- -- 68,083 Mortgage-backed securities .... 40,224 35,830 6,501 4,387 3,861 90,803 -- Total loans and mortgage-backed securities 8,300,286 277,433 1,414,549 68,983 26,862 10,088,113 -- Total interest-earning assets .... $8,564,970 $ 295,326 $1,540,256 $ 69,051 $ 26,862 $10,496,465 == Transaction accounts: Non-interest-bearing checking .... $ 312,962 $ -- $ -- $ -- $ -- $ 312,962 Interest-bearing checking ....(3) 436,612 -- -- -- -- 436,612 Money market ....(4) 112,646 -- -- -- -- 112,646 Regular passbook ....(4) 2,789,500 -- -- -- -- 2,789,500 -- Total transaction accounts .... 3,651,720 -- -- -- -- 3,651,720 Certificates of deposit ....(1) 2,823,767 1,276,030 847,373 -- -- 4,947,170 -- Total deposits .... 6,475,487 1,276,030 847,373 -- -- 8,598,890 Borrowings .... 123,255 56,781 710,350 430,000 -- 1,320,386 Capital securities .... -- -- -- -- 120,000 120,000 -- Total deposits, borrowings and capital securities .... $6,598,742 $ 1,332,811 $1,557,723 $ 430,000 $120,000 $10,039,276 == Excess (shortfall) of interest-earning assets over deposits, borrowings and capital securities .... $1,966,228 $(1,037,485) $ (17,467) $(360,949) $(93,138) $ 457,189 Cumulative gap .... 1,966,228 928,743 911,276 550,327 457,189 Cumulative gap - as a % of total assets: March 31, 2002 .... 18.02% 8.51% 8.35% 5.04% 4.19% December 31, 2001 .... 12.01 4.76 7.91 4.71 3.86 March 31, 2001 .... 19.74 3.99 6.45 3.63 3.31 ==

(1) Based upon contractual maturity and repricing date. (2) Based upon contractual maturity, repricing date and projected repayment and prepayments of principal. (3) Included amounts swept into money market deposit accounts and is subject to immediate repricing. (4) Subject to immediate repricing. 27 Our six-month gap at March 31, 2002 was a positive 18.02%. This means that more interest-earning assets reprice within six months than total deposits, borrowings and capital securities. This compares to a positive six-month gap of 12.01% at December 31, 2001 and 19.74% at March 31, 2001. We continue to pursue our strategy of emphasizing the origination of adjustable rate mortgages. For the twelve months ended March 31, 2002, we originated and purchased for investment $3.7 billion of adjustable rate loans which represented approximately 99% of all loans we originated and purchased for investment during the period. At March 31, 2002, 99% of our interest-earning assets mature, reprice or are estimated to prepay within five years, unchanged from December 31, 2001 and up slightly from 98% at March 31, 2001. At March 31, 2002, loans held for investment and mortgage-backed securities with adjustable interest rates represented 92% of those portfolios. During the first quarter of 2002, 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 to originate adjustable rate mortgages and to generate fees 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, 2002, $9.4 billion or 93% 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 $9.3 billion or 91% at December 31, 2001, and $9.4 billion or 91% at March 31, 2001. The following table sets forth the interest rate spread between our interest-earning assets and interest-bearing liabilities at the dates indicated. March 31, December 31, September 30, June 30, March 31, 2002 2001 2001 2001 2001 -- Weighted average yield: Loans and mortgage-backed securities 6.45% 7.15% 7.68% 8.24% 8.56% Federal Home Loan Bank stock .... 5.30 5.31 6.00 6.00 5.51 Investment securities .... 3.43 3.54 5.18 5.38 6.00 -- Interest-earning assets yield .... 6.35 6.98 7.59 8.12 8.46 -- Weighted average cost: Deposits .... 2.98 3.65 4.46 5.08 5.40 Borrowings: Federal Home Loan Bank advances .. 4.63 3.73 4.70 5.36 5.94 Other borrowings .... -- 7.88 7.88 7.88 7.88 -- Total borrowings .... 4.63 3.73 4.70 5.36 5.94 Capital securities .... 10.00 10.00 10.00 10.00 10.00 -- Combined funds cost .... 3.28 3.74 4.55 5.16 5.53 -- Interest rate spread .... 3.07% 3.24% 3.04% 2.96% 2.93% == The period-end weighted average yield on our loan portfolio declined to 6.45% at March 31, 2002, down from 7.15% at December 31, 2001 and 8.56% at March 31, 2001. At March 31, 2002, our adjustable rate mortgage portfolio of single family residential loans, including mortgage-backed securities, totaled $9.1 billion with a weighted average rate of 6.35%, compared to $9.0 billion with a weighted average rate of 7.11% at December 31, 2001, and $9.0 billion with a weighted average rate of 8.65% at March 31, 2001. 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 $1 million during the current quarter to $94 million or 0.86% of total assets. This increase was primarily due to a $2 million rise in commercial real estate non-accrual loans as a result of a shopping center loan whose principal tenant declared bankruptcy during the quarter and ceased paying rent. Non-performing assets at quarter end included non-accrual loans aggregating $4 million which were not contractually past due, but were deemed non-accrual due to management's assessment of the borrower's ability to pay. 28 The following table summarizes our non-performing assets at the dates indicated. March 31, December 31, September 30, June 30, March 31, (Dollars in Thousands) 2002 2001 2001 2001 2001 -- Non-accrual loans: Residential one-to-four units .... $43,934 $43,210 $29,266 $22,494 $16,965 Residential one-to-four units - subprime .... 33,169 31,166 31,076 25,737 26,353 Other .... 4,589 2,668 2,927 3,054 3,367 -- Total non-accrual loans

.... 81,692 77,044 63,269 51,285 46,685 Troubled debt restructure - below market rate (1) ... 203 203 204 204 205 Real estate acquired in settlement of loans .... 11,917 15,366 11,870 8,366 11,634 Repossessed automobiles .... 19 19 28 37 15 -- Total non-performing assets .... $93,831 $92,632 $75,371 $59,892 $58,539 == Allowance for loan losses: Amount .... $37,307 $36,120 $35,043 $34,301 $34,059 As a percentage of non-performing loans .... 45.55% 46.76% 55.21% 66.62% 72.64% Non-performing assets as a percentage of total assets 0.86 0.83 0.70 0.55 0.53 == (1) Represents a residential single one-to-four unit loan. Delinquent Loans Loans delinquent 30 days or more declined during the first quarter to 1.05% at March 31, 2002, from 1.10% at December 31, 2001, but were above the 0.73% of a year ago. The decline during the current quarter primarily occurred in our residential one-to-four units category. 29 The following table indicates the amounts of our past due loans at the dates indicated. March 31, 2002 December 31, 2001 -- 30-59 60-89 90+ 30-59 60-89 90+ (Dollars in Thousands) Days Days Days (1) Total Days Days Days (1) Total -- Loans secured by real estate: Residential: One-to-four units .... $ 19,454 $ 6,360 $ 34,724 $ 60,538 $ 19,170 $ 12,797 $ 33,449 $ 65,416 One-to-four units - subprime 13,653 4,175 25,797 43,625 13,159 9,104 20,958 43,221 Five or more units .... -- -- -- -- -- -- -- -- Commercial real estate .... -- -- -- -- -- -- -- -- Construction .... -- -- -- -- -- -- -- -- Land .... -- -- -- -- -- -- -- -- -- Total real estate loans .... 33,107 10,535 60,521 104,163 32,329 21,901 54,407 108,637 Non-mortgage: Commercial .... -- -- 637 637 -- -- 1,163 1,163 Automobile .... 138 14 79 231 174 85 46 305 Other consumer .... 142 57 185 384 356 62 173 591 -- Total delinquent loans ..... $ 33,387 $ 10,606 $ 61,422 $105,415 $ 32,859 $ 22,048 $ 55,789 $110,696 == Delinquencies as a percentage of total loans .... 0.33% 0.11% 0.61% 1.05% 0.33% 0.22% 0.55% 1.10% == September 30, 2001 June 30, 2001 -- Loans secured by real estate: Residential: One-to-four units .... $18,515 $ 8,165 $25,131 $51,811 $15,190 $ 7,262 $17,291 $39,743 One-to-four units - subprime 11,212 8,569 21,649 41,430 11,402 6,513 20,772 38,687 Five or more units .... -- -- -- -- -- -- 248 248 Commercial real estate .... -- -- -- -- -- -- -- -- Construction .... -- -- -- -- -- -- -- -- Land .... -- -- -- -- -- -- -- -- -- Total real estate loans .... 29,727 16,734 46,780 93,241 26,592 13,775 38,311 78,678 Non-mortgage: Commercial .... -- -- 1,290 1,290 -- -- 1,290 1,290 Automobile .... 269 54 80 403 112 63 32 207 Other consumer .... 253 38 264 555 287 28 185 500 -- Total delinquent loans ..... $30,249 $16,826 $48,414 $95,489 $26,991 $13,866 $39,818 $80,675 == Delinquencies as a percentage of total loans .... 0.30% 0.17% 0.49% 0.96% 0.27% 0.14% 0.40% 0.81% == March 31, 2001 -- Loans secured by real estate: Residential: One-to-four units .... $14,166 $ 6,961 $15,490 $36,617 One-to-four units - subprime 11,223 6,651 17,860 35,734 Five or more units .... -- -- 508 508 Commercial real estate .... -- -- -- -- Construction .... -- -- -- -- Land .... -- -- -- -- -- Total real estate loans .... 25,389 13,612 33,858 72,859 Non-mortgage: Commercial .... -- 1,290 -- 1,290 Automobile .... 230 55 74 359 Other consumer .... 189 31 190 410 -- Total delinquent loans $25,808 $14,988 $34,122 $74,918

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Delinquencies as a percentage of total loans 0.25% 0.15% 0.33% 0.73%
== (1) All 90 day or greater delinquencies are on non-accrual status and reported as part of non-performing assets. 30 Allowance for Losses on Loans and Real Estate We maintain a valuation allowance 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 valuation 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 both these allowances are those amounts associated with assets where it is probable that the recorded value of the asset declined and the loss can be reasonably estimated. If we determine the carrying value of our asset exceeds its net fair value and no alternative payment source exists, then 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 $38 million at March 31, 2002, compared to $39 million at December 31, 2001, and $37 million at March 31, 2001. Our provision for loan losses was $1.4 million in the current quarter and exceeded our net loan charge-offs by $1.2 million resulting in an increase in the allowance for loan losses to $37.3 million at March 31, 2002. The current quarter allowance increase reflected an increase of $1.2 million in allocated allowances due primarily to a commercial real estate loan that became impaired during the quarter. There were no changes in our general valuation allowances or our unallocated allowance of $2.8 million. The following table summarizes the activity in our allowance for loan losses during the periods indicated. Three Months Ended -- March 31, December 31, September 30, June 30, March 31, (In Thousands) 2002 2001 2001 2001 2001
-- Balance at beginning of period $ 36,120 $ 35,043 $ 34,301 $ 34,059 $ 34,452 Provision .... 1,447 1,290 791 431 52 Charge-offs .... (276) (316) (198) (326) (508) Recoveries 16 103 149 137 63
-- Balance at end of period ..... $ 37,307 $ 36,120 $ 35,043 $ 34,301 $ 34,059
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31 The following table presents by category of loan gross charge-offs, gross recoveries and net charge-offs during the periods indicated. Three Months Ended -- March 31, December 31, September 30, June 30, March 31, (Dollars in Thousands) 2002 2001 2001 2001 2001
-- GROSS LOAN CHARGE-OFFS Loans secured by real estate: Residential: One-to-four units .... $ 125 $ 108 $ 25 $ 115 $ 282 One-to-four units - subprime .... 17 70 60 92 122 Five or more units .... -- -- -- -- -- Commercial real estate .... -- -- -- -- -- Construction .... -- -- -- -- -- Land .... -- -- -- -- -- Non-mortgage: Commercial .... -- -- -- -- -- Automobile .... 52 51 26 72 48 Other consumer 82 87 87 47 56
-- Total gross loan charge-offs 276 316 198 326 508
-- GROSS LOAN RECOVERIES Loans secured by real estate: Residential: One-to-four units .... 9 1 86 121 59 One-to-four units - subprime .... -- 100 61 5 -- Five or more units .... -- -- -- -- -- Commercial real estate .... -- -- -- 1 -- Construction .... -- -- -- -- -- Land .... -- -- -- -- -- Non-mortgage: Commercial .... -- -- -- -- -- Automobile .... 5 -- -- 4 -- Other consumer 2 2 2 6 4
-- Total gross loan recoveries 16 103 149 137 63

-- NET LOAN CHARGE-OFFS Loans secured by real estate: Residential: One-to-four units .... 116 107 (61) (6) 223 One-to-four units - subprime .... 17 (30) (1) 87 122 Five or more units .... -- -- -- -- -- Commercial real estate .... -- -- -- (1) -- Construction .... -- -- -- -- -- Land .... -- -- -- -- -- Non-mortgage: Commercial .... -- -- -- -- -- Automobile .... 47 51 26 68 48 Other consumer .... 80 85 85 41 52 -- Total net loan charge-offs .... $ 260 $ 213 $ 49 $ 189 $ 445 ==

Net loan charge-offs as a percentage of average loans 0.01% 0.01% -% 0.01% 0.02% ==

32 The following table indicates our allocation of the allowance for loan losses to the various categories of loans at the dates indicated. March 31, 2002 December 31, 2001 September 30, 2001 -- Gross Allowance Gross Allowance Gross Allowance Loan Percentage Loan Percentage Loan Percentage Portfolio to Loan Portfolio to Loan Portfolio to Loan (Dollars in Thousands) Allowance Balance Balance Allowance Balance Balance Allowance Balance Balance -- Loans secured by real estate: Residential: One-to-four units ...... $18,566 $7,869,433 0.24% $19,033 $7,699,061 0.25% $16,598 $7,567,462 0.22% One-to-four units-subprime .... 9,755 1,436,760 0.68 9,633 1,506,719 0.64 10,385 1,605,994 0.65 Five or more units ..... 76 10,150 0.75 84 11,179 0.75 86 11,489 0.75 Commercial real estate ... 3,367 110,341 3.05 1,848 112,509 1.64 2,262 142,480 1.59 Construction .... 920 78,202 1.18 1,005 84,942 1.18 1,164 99,161 1.17 Land .... 446 36,303 1.23 274 22,028 1.24 262 21,121 1.24 Non-mortgage: Commercial .... 511 21,182 2.41 573 22,017 2.60 650 22,762 2.86 Automobile .... 292 20,902 1.40 277 24,529 1.13 196 29,109 0.67 Other consumer .... 574 48,067 1.19 593 50,908 1.16 640 53,243 1.20 Not specifically allocated .. 2,800 -- -- 2,800 -- -- 2,800 -- -- -- Total loans held for investment .... $37,307 $9,631,340 0.39% $36,120 $9,533,892 0.38% $35,043 $9,552,821 0.37% ==

June 30, 2001 March 31, 2001 -- Loans secured by real estate: Residential: One-to-four units ...... $15,139 $7,506,027 0.20% $14,599 $7,652,325 0.19% One-to-four units-subprime .... 10,826 1,701,558 0.64 11,071 1,765,656 0.63 Five or more units ..... 141 18,823 0.75 142 18,915 0.75 Commercial real estate ... 2,703 157,749 1.71 2,709 162,169 1.67 Construction .... 1,171 99,261 1.18 1,142 96,564 1.18 Land .... 263 21,283 1.24 261 21,230 1.23 Non-mortgage: Commercial .... 422 21,648 1.95 424 21,312 1.99 Automobile .... 175 32,594 0.54 234 36,590 0.64 Other consumer .... 661 56,096 1.18 677 58,610 1.16 Not specifically allocated .. 2,800 -- -- 2,800 -- -- --- Total loans held for investment .... $34,301 $9,615,039 0.36% $34,059 $9,833,371 0.35% ==

At March 31, 2002, the recorded investment in loans for which we recognized impairment totaled $17 million, up from $13 million at December 31, 2001. The allowance for losses related to these loans increased from $1 million at December 31, 2001, to $2 million at March 31, 2002. During the first quarter of 2002, total interest recognized on the impaired loan portfolio was $0.3 million. The following table summarizes the activity in our allowance for loan losses associated with impaired loans during the periods indicated. Three Months Ended --- March 31, December 31, September 30, June 30, March 31, (In Thousands) 2002 2001 2001 2001 2001 -- Balance at beginning of period $ 759 $ 1,210 $ 782 $ 798 $ 800 Provision (reduction) .... 1,597 (451) 428 (16) (2) Charge-offs .... -- -- -- -- -- Recoveries .... -- -- -- -- -- -- Balance at end of period ..... $ 2,356 $ 759 $ 1,210 $ 782 $ 798 ==

33 The following table summarizes the activity in our allowance for real estate and joint ventures held for investment

during the periods indicated. Three Months Ended -- March 31, December 31, September 30, June 30, March 31, (In Thousands) 2002 2001 2001 2000 2001 -- Balance at beginning of period $ 2,690 $ 2,689 $ 3,063 $ 3,030 $ 2,997 Provision (reduction) .... (1,318) 1 (374) 33 33 Charge-offs .... (339) -- -- -- -- Recoveries .... -- -- -- -- -- -- Balance at end of period ..... $ 1,033 $ 2,690 $ 2,689 $ 3,063 $ 3,030 ==

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 2002 were from: o principal repayments--including prepayments, but excluding refinances of our existing loans--on loans and mortgage-backed securities of $786 million; o maturities and sales of U.S. Treasury securities, agency obligations and other investment securities available for sale of $225 million; and o a net decrease of our loans held for sale of $111 million. We used these funds for the following purposes: o to originate and purchase loans held for investment, excluding refinances of our existing loans, of $851 million; o to paydown our borrowings by $202 million; and o to purchase U.S. Treasury securities, agency obligations and other investment securities available for sale of $75 million. Our principal source of liquidity is our ability to utilize borrowings, as needed. Our primary source of borrowings is the FHLB. At March 31, 2002, our FHLB borrowings totaled $1.3 billion, representing 12.1% of total assets. We currently are approved by the FHLB to borrow up to 40% of total assets to the extent we provide qualifying collateral and hold sufficient FHLB stock. That approved limit would have permitted us, as of quarter end, to borrow an additional $3.0 billion. To the extent deposit growth over the remainder of 2002 falls short of satisfying ongoing commitments to fund maturing and withdrawable deposits, repay maturing borrowings, fund existing and future loans, make investments, and continue branch improvement programs, we will utilize our FHLB borrowing arrangement or possibly other sources. As of March 31, 2002, we had commitments to borrowers for short-term rate locks of $660 million, undisbursed loan funds and unused lines and letters of credit of $145 million, and other contingent liabilities of $3 million. We believe our current sources of funds enable us to meet these obligations while maintaining our liquidity at appropriate levels. Another measure of liquidity in the savings and loan industry is the ratio of cash and eligible investments to the sum of withdrawable savings and borrowings due within one year. At March 31, 2002, the Bank's ratio was 3.9%, compared to 4.3% at December 31, 2001 and 4.6% at March 31, 2001. The holding company currently has liquid assets, including due from Bank--interest-bearing balances, of $22 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 $768 million at March 31, 2002, up from $734 million at December 31, 2001 and $649 million at March 31, 2001. 34 REGULATORY CAPITAL Our core and tangible capital ratios were both 7.61% and our risk-based capital ratio was 15.39%. 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. The following table is a reconciliation of the Bank's stockholder's equity to federal regulatory capital as of March 31, 2002. Tangible Capital Core Capital Risk-Based Capital -------------------- ------------------- -------------------- (Dollars in Thousands) Amount Ratio Amount Ratio Amount Ratio -- Stockholder's equity .... $860,022 $860,022 $860,022 Adjustments: Deductions: Investment in subsidiary, primarily real estate .... (24,094) (24,094) (24,094) Excess cost over fair value of branch acquisitions .... (3,039) (3,039) (3,039) Non-permitted mortgage servicing rights . (6,858) (6,858) (6,858) Additions: Unrealized losses on securities available for sale .... 1,288 1,288 1,288 General loss allowance - investment in DSL Service Company .... 46 46 46 Allowance for loan losses, net of specific allowances (1) .... -- -- 35,631 -- Regulatory capital .... 827,365 7.61% 827,365 7.61% 862,996 15.39% Well capitalized requirement .... 163,051 1.50 (2) 543,504 5.00 560,615 10.00 (3) -- Excess $664,314 6.11% $283,861 2.61% $302,381 5.39%

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(1) Limited to 1.25% of risk-weighted assets. (2) Represents the minimum requirement for tangible capital, as no "well capitalized" requirement has been established for this category. (3) A third requirement is Tier 1 capital to risk-weighted assets of 6.00%,which the Bank met and exceeded with a ratio of 14.76%. 35 PART II -- OTHER INFORMATION Item 6 - Exhibits and Reports on Form 8-K (A) Exhibits. (B) Form 8-K filed January 17, 2002. 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 1, 2002 /s/ DANIEL D. ROSENTHAL -- Daniel D. Rosenthal President and Chief Executive Officer Date: May 1, 2002 /s/ THOMAS E. PRINCE -- Thomas E. Prince Executive Vice President and Chief Financial Officer 36