DOWNEY FINANCIAL CORP
Form 10-Q
August 01, 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 JUNE 30, 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 June 30, 2001, 28,211,048 shares of the Registrant's Common Stock, $0.01 par value were outstanding.

DOWNEY FINANCIAL CORP.

JUNE 30, 2001 QUARTERLY REPORT ON FORM 10-Q

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PART I - FINANCIAL INFORMATION

DOWNEY FINANCIAL CORP. AND SUBSIDIARIES

Consolidated Balance Sheets

(Dollars in Thousands, Except Per Share Data)	June 30, 2001	D
ASSETS		
Cash	$ 110,932	$
Federal funds	35,600	
Cash and cash equivalents	146,532	
U.S. Treasury securities, agency obligations and other investment securities available for sale, at fair value	262,835	
Municipal securities held to maturity, at amortized cost (estimated market value of $6,534 at June 30, 2001 and December 31, 2000 and $6,709 at June 30, 2000)	6,550	
Mortgage loans purchased under resale agreements	40,000	
Loans held for sale, at lower of cost or market	376,560	
Mortgage-backed securities available for sale, at fair value	5,234	
Loans receivable held for investment	9,599,419	
Investments in real estate and joint ventures	19,950	
Real estate acquired in settlement of loans	8,366	
Premises and equipment	104,591	
Federal Home Loan Bank stock, at cost	110,036	
Mortgage servicing rights, net	42,142	
Other assets	99,701	
	$10,821,916	$
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits	$ 9,040,064	$

Federal Home Loan Bank advances	892,670
Other borrowings	94
Accounts payable and accrued liabilities	55,642
Deferred income taxes	32,727
Total liabilities	10,021,197
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 June 30, 2001, 28,205,741 shares at December 31, 2000 and 28,170,388 shares at June 30, 2000	282
Additional paid-in capital	93,374
Accumulated other comprehensive income (loss)	2,394
Retained earnings	584,669
Total stockholders' equity	680,719
	$10,821,916 $

See accompanying notes to consolidated financial statements.

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DOWNEY FINANCIAL CORP. AND SUBSIDIARIES

Consolidated Statements of Income

(Dollars in Thousands, Except Per Share Data)	Three Months Ended June 30, 2001	2000
INTEREST INCOME		
Loans receivable	$ 203,820	$ 186,6
U.S. Treasury securities and agency obligations	4,122	3,1
Mortgage-backed securities	87	3
Other investments	3,206	2,6
Total interest income	211,235	192,7
INTEREST EXPENSE		
Deposits	114,386	90,2
Borrowings	17,562	35,8
Capital securities	3,041	3,0
Total interest expense	134,989	129,1
NET INTEREST INCOME	76,246	63,5
PROVISION FOR LOAN LOSSES	431	9
Net interest income after provision for loan losses	75,815	62,6
OTHER INCOME, NET		
Loan and deposit related fees	14,136	7,0

Real estate and joint ventures held for investment, net:		
Operations, net	725	2,2
Net gains on sales of wholly owned real estate	--	--
Provision for losses on real estate and joint ventures	(33)	(1,4
Secondary marketing activities:		
Loan servicing fees	(2,898)	3
Net gains on sales of loans and mortgage-backed securities	8,962	7
Net gains on sale of mortgage servicing rights	671	--
Net gains (losses) on sales of investment securities	114	(
Gain on sale of subsidiary	--	--
Other	606	7
Total other income, net	22,283	9,4
OPERATING EXPENSE		
Salaries and related costs	24,646	19,9
Premises and equipment costs	6,042	5,8
Advertising expense	1,127	8
Professional fees	1,604	6
SAIF insurance premiums and regulatory assessments	741	6
Other general and administrative expense	5,973	4,8
Total general and administrative expense	40,133	32,7
Net operation of real estate acquired in settlement of loans	(106)	
Amortization of excess of cost over fair value of net assets acquired	114	1
Total operating expense	40,141	32,9
INCOME BEFORE INCOME TAXES	57,957	39,1
Income taxes	24,502	16,6
Net income before cumulative effect of change in accounting principle	33,455	22,4
Cumulative effect of change in accounting principle, net of taxes	--	--
NET INCOME	$ 33,455	$ 22,4
PER SHARE INFORMATION		
Basic before cumulative effect of change in accounting principle	$ 1.18	$ 0.
BASIC AFTER CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	1.18	0.
Diluted before cumulative effect of change in accounting principle	$ 1.18	$ 0.
DILUTED AFTER CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE	1.18	0.
CASH DIVIDENDS DECLARED AND PAID	$ 0.09	$ 0.
Weighted average diluted shares outstanding	28,271,014	28,204,3

See accompanying notes to consolidated financial statements.

DOWNEY FINANCIAL CORP. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income

	Three Months Ende June 30,	
(In Thousands)	2001	2000

NET INCOME	$ 33,455	$ 22,48
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	(152)	24
Mortgage-backed securities available for sale, at fair value	22	2
Less reclassification of realized (gains) losses included in net income	(66)	5
Unrealized gains (losses) on cash flow hedges:		
Net derivative instruments	2,045	--
Cumulative effect of change in accounting principle	--	--
Less reclassification of realized (gains) losses included in net income	(637)	--
Total other comprehensive income (loss), net of income taxes (benefits) ...	1,212	32
COMPREHENSIVE INCOME	$ 34,667	$ 22,80

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, mortgage servicing rights, 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	(2,
Proceeds from sales of loans held for sale, including those sold via mortgage-backed securities	1,
Other, net	
Net cash used for operating activities	(
CASH FLOWS FROM INVESTING ACTIVITIES	
Proceeds from sale 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	

Purchase of:	
U.S. Treasury securities, agency obligations and other investment securities available for sale	(
Mortgage loans under resale agreements	
Loans receivable held for investment	
Federal Home Loan Bank stock	
Originations of loans receivable held for investment (net of refinances of $377,262 at June 30, 2001 and $62,778 at June 30, 2000)	(1,
Principal payments on loans receivable held for investment and mortgage-backed securities available for sale	1,
Net change in undisbursed loan funds	
Proceeds from (investments in) real estate held for investment	
Other, net	
Net cash provided by (used for) investing activities	

See accompanying notes to consolidated financial statements.

DOWNEY FINANCIAL CORP. AND SUBSIDIARIES

Consolidated Statements of Cash Flows (Continued)

	Six Months June 3	
(In Thousands)	2001	
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	$ 957,375	$
Proceeds from Federal Home Loan Bank advances	1,043,200	
Repayments of Federal Home Loan Bank advances	(2,128,878)	
Net decrease in other borrowings	(130)	
Proceeds from exercise of stock options	135	
Cash dividends	(5,078)	
Net cash provided by (used for) financing activities	(133,376)	
Net increase (decrease) in cash and cash equivalents	18,729	
Cash and cash equivalents at beginning of period	127,803	
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 146,532	$
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	$ 284,408	$
Income taxes	40,956	
Supplemental disclosure of non-cash investing:		
Loans transferred to held for investment from held for sale	3,179	
Loans exchanged for mortgage-backed securities	1,534,584	
Real estate acquired in settlement of loans	9,302	
Loans to facilitate the sale of real estate acquired in settlement of loans	5,202	

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 June 30, 2001, December 31, 2000 and June 30, 2000, the results of operations and comprehensive income for the three months and six months ended June 30, 2001 and 2000, and changes in cash flows for the six months ended June 30, 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 for the periods indicated.

	Three Months Ended June 30,			
	2001		2000	
(Dollars in Thousands, Except Per Share Data)	Net Income	Per Share Amount	Net Income	Per Sh Amou
Basic earnings per share	$33,455	$1.18	$22,482	$
Effect of dilutive stock options ..	--	--	--	
Diluted earnings per share	$33,455	$1.18	$22,482	$
WEIGHTED AVERAGE SHARES OUTSTANDING				
Basic		28,211,048		28,160
Dilutive stock options		59,966		43

Diluted	28,271,014	28,204

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(Dollars in Thousands, Except Per Share Data)	Six Months Ended June 30, 2001 Net Income	Per Share Amount	20 Net Income
BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE			
Basic earnings per share	$59,283	$2.10	$49,918
Effect of dilutive stock options	--	--	--
Diluted earnings per share	$59,283	$2.10	$49,918
AFTER CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE			
Basic earnings per share	$59,319	$2.09	$49,918
Effect of dilutive stock options	--	--	--
Diluted earnings per share	$59,319	$2.09	$49,918
WEIGHTED AVERAGE SHARES OUTSTANDING			
Basic		28,210,364	
Dilutive stock options		62,735	
Diluted		28,273,099	

NOTE (3) - BUSINESS SEGMENT REPORTING

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

(In Thousands)	Banking	Real Estate Investment	Elimination	Tot
THREE MONTHS ENDED JUNE 30, 2001				
Net interest income	$ 76,236	$ 10	$ --	$ 76
Provision for loan losses	431	--	--	
Other income	21,211	1,072	--	22
Operating expense	38,863	1,278	--	40
Net intercompany income (expense)	84	(84)	--	
Income (loss) before income taxes (benefit)	58,237	(280)	--	57
Income taxes (benefit)	24,618	(116)	--	24
Net income (loss)	$ 33,619	$ (164)	$ --	$ 33
AT JUNE 30, 2001				
Assets:				
Loans and mortgage-backed securities .	$ 9,981,213	$ --	$ --	$ 9,981
Real estate held for investment	--	19,950	--	19
Other	837,387	1,673	(18,307)	820

Total assets	10,818,600	21,623	(18,307)	10,821
Equity	$ 680,719	$ 18,307	$ (18,307)	$ 680
THREE MONTHS ENDED JUNE 30, 2000				
Net interest income	$ 63,501	$ 64	$ --	$ 63
Provision for loan losses	942	--	--	
Other income	8,640	827	--	9
Operating expense	32,558	366	--	32
Net intercompany income (expense)	107	(107)	--	
Income before income taxes	38,748	418	--	39
Income taxes	16,511	173	--	16
Net income	$ 22,237	$ 245	$ --	$ 22
AT JUNE 30, 2000				
Assets:				
Loans and mortgage-backed securities	$ 9,787,661	$ --	$ --	$ 9,787
Real estate held for investment	--	39,256	--	39
Other	683,771	7,655	(41,753)	649
Total assets	10,471,432	46,911	(41,753)	10,476
Equity	$ 577,496	$ 41,753	$ (41,753)	$ 577

(In Thousands)	Banking	Real Estate Investment	Elimination	Totals
SIX MONTHS ENDED JUNE 30, 2001				
Net interest income	$152,370	$ 38	$ --	$152,408
Provision for loan losses	483	--	--	483
Other income	25,894	2,340	--	28,234
Operating expense	75,853	1,538	--	77,391
Net intercompany income (expense)	181	(181)	--	--
Income before income taxes	102,109	659	--	102,768
Income taxes	43,217	268	--	43,485
Net income before cumulative effect of change in accounting principle	58,892	391	--	59,283
Cumulative effect of change in accounting principle, net of income taxes	36	--	--	36
Net income	$ 58,928	$ 391	$ --	$ 59,319
SIX MONTHS ENDED JUNE 30, 2000				
Net interest income	$126,216	$ 112	$ --	$126,328
Provision for loan losses	1,733	--	--	1,733
Other income:				
Gain on sale of subsidiary	9,762	--	--	9,762
All other	17,225	3,957	--	21,182
Operating expense	68,042	607	--	68,649
Net intercompany income (expense)	215	(215)	--	--

Income before income taxes	83,643	3,247	--	86,890
Income taxes	35,639	1,333	--	36,972
Net income	$ 48,004	$ 1,914	$ --	$ 49,918

NOTE (4) - MORTGAGE SERVICING RIGHTS

The following table is a summary of the activity in our mortgage servicing rights and related allowance for the periods indicated and other related financial data.

	Three Months		
(Dollars in Thousands)	June 30, 2001	March 31, 2001	December 3 2000
Gross balance at beginning of period	$ 49,323	$ 46,214	$ 45,834
Additions	13,403	5,394	2,548
Amortization	(2,299)	(2,063)	(1,803)
Sale of servicing	(2,328)	--	--
Impairment write-down	(2,251)	(222)	(365)
Gross balance at end of period	55,848	49,323	46,214
Allowance balance at beginning of period	13,606	5,483	820
Provision for impairment	2,351	8,345	5,028
Impairment write-down	(2,251)	(222)	(365)
Allowance balance at end of period	13,706	13,606	5,483
Total mortgage servicing rights, net	$ 42,142	$ 35,717	$ 40,731
Estimated fair value (1)	$ 42,142	$ 35,752	$ 41,826
AT PERIOD END			
Mortgage loans serviced for others:			
Total	$ 5,056,120	$ 4,296,883	$ 3,964,462
With capitalized mortgage servicing rights (2):			
Amount	4,456,822	3,999,380	3,779,562
Weighted average interest rate	7.29%	7.50%	7.56%
Custodial escrow balances	$ 9,924	$ 5,281	$ 8,207

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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 on 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 June 30, 2001, we had rate lock commitments estimated to sell as part of our secondary marketing activities of $264 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 June 30, 2001, forward sale contracts amounted to $698 million, of which $358 million were designated as cash flow hedges, and forward purchase contracts totaled $45 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.

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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.

Note (8) - CURRENT ACCOUNTING ISSUES

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 141, "Business Combinations" ("SFAS 141") and Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142").

SFAS 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. The use of the pooling-of-interests method will be prohibited. It is not anticipated that the financial impact of this statement will have a material effect on Downey.

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 will carry 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. For the first six months of 2001, the amortization of excess of cost over fair value of net assets acquired was $0.2 million and as of June 30, 2001, goodwill amounted to $3.4 million. It is not anticipated that the financial impact of this statement will have a material effect on Downey.

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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 second quarter of 2001 totaled a record $33.4 million or $1.18 per share on a diluted basis, up 48.8% from the $22.5 million or $0.80 per share in the second quarter of 2000.

The increase in our net income between second quarters was due to higher net income from our banking operations, which increased $11.4 million or 51.2% to $33.6 million reflecting the following:

- net interest income increased $12.7 million or 20.1% due to increases in both average earning assets and the effective interest rate spread;
- other income increased $12.6 million, more than double the year-ago level, due to higher net gains from sales of loans and mortgage-backed securities, and loan and deposit related fees; and
- provision for loan losses declined by $0.5 million.

Those favorable items were partially offset by a $6.3 million increase in operating expense due to higher costs associated with an increased number of branch locations and higher loan origination activity, and a $2.4 million addition to the valuation allowance for mortgage servicing rights due to the continued drop in interest rates which reduced the value associated with custodial deposits.

For the first six months of 2001, our net income totaled $59.3 million or $2.09 per share on a diluted basis. This represents an increase of 33.9% over the $44.3 million or $1.57 per share in the year-ago period, excluding the $5.6 million or $0.20 per share after-tax gain from the sale of our indirect automobile finance subsidiary. Including the gain, our net income for the first six months of 2000 totaled $49.9 million or $1.77 per share on a diluted basis. The increase between six month periods primarily reflected higher net income from our banking operations.

For the second quarter of 2001, our return on average assets was 1.22% and our return on average equity was 20.15%. For the first six months of 2001, our return on average assets was 1.08% and our return on average equity was 18.26%.

At June 30, 2001, our assets totaled $10.8 billion, up $345 million or 3.3% from a year ago, but down $209 million or 1.9% from March 31, 2001. Our single family loan originations totaled a record $2.122 billion in the second quarter of 2001, up 52.7% from the $1.390 billion we originated in the second quarter of 2000 and 47.6% above the $1.438 billion we originated in the first quarter of 2001. Of the current quarter total, $826 million represented originations of loans for portfolio, of which $110 million represented subprime credits. In addition to single family loans, we originated $43 million of other loans in the quarter.

Between second quarters, we funded our asset growth with a $1.8 billion or 24.0% increase in deposits. At quarter-end, our deposits totaled $9.0 billion. During the quarter, one new traditional branch and seven new in-store branches were opened, bringing our total branches at quarter end to 129, of which 63 are in-store. A year ago, branches totaled 104, of which 40 were in-store.

Our non-performing assets increased only $1 million during the quarter to $60 million or 0.55% of total assets.

At June 30, 2001, our primary subsidiary, Downey Savings and Loan Association, F.A. (the "Bank"), had core and tangible capital ratios of 6.95% and a risk-based capital ratio of 13.84%. 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.

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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 second quarter of 2001, up $12.7 million or 19.9% from the same period last year. The improvement between second quarters reflected increases in both average earning assets and the effective interest rate spread. Our average earning assets increased by $633 million or 6.4% between second quarters to $10.6 billion. Our effective interest rate spread of 2.89% in the current quarter was up from the year-ago quarter level of 2.56%. This improvement reflected an increase in our earning asset yield between second quarters, while our cost of funds declined. 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 current quarter effective interest rate spread was up 2 basis points from the first quarter 2001 level, as our earning asset yield fell more consistent with our cost of funds on a linked-quarter basis. For the first six months of 2001, net interest income totaled $152.4 million, up $26.1 million or 20.6% from a year ago.

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 using the average of each month's daily average balance during the periods indicated.

	Three Months Ended June 30,				
	2001			2000	
(Dollars in Thousands)	Average Balance	Interest	Average Yield/ Rate	Average Balance	Interest

Interest-earning assets:					
Loans	$10,057,634	$203,820	8.11%	$ 9,581,579	$186,648
Mortgage-backed securities	5,651	87	6.16	17,963	300
Investment securities	501,169	7,328	5.86	331,885	5,752
Total interest-earning assets	10,564,454	211,235	8.00	9,931,427	192,700
Non-interest-earning assets	362,519			349,115	
Total assets	$10,926,973			$10,280,542	
Transaction accounts:					
Non-interest-bearing checking .	$ 296,370	$ --	-- %	$ 200,540	$ --
Interest-bearing checking (1) .	408,931	499	0.49	384,499	922
Money market	89,960	629	2.80	89,028	629
Regular passbook	875,580	7,515	3.44	806,793	7,053
Total transaction accounts ..	1,670,841	8,643	2.07	1,480,860	8,604
Certificates of deposit	7,102,427	105,743	5.97	5,651,092	81,615
Total deposits	8,773,268	114,386	5.23	7,131,952	90,219
Borrowings	1,241,535	17,562	5.67	2,361,491	35,875
Capital securities	120,000	3,041	10.14	120,000	3,041
Total deposits, borrowings and capital securities	10,134,803	134,989	5.34	9,613,443	129,135
Other liabilities	128,086			100,853	
Stockholders' equity	664,084			566,246	
Total liabilities and stockholders' equity	$10,926,973			$10,280,542	
Net interest income/interest rate spread		$ 76,246	2.66%		$ 63,565
Excess of interest-earning assets over deposits, borrowings and capital securities	$ 429,651			317,984	
Effective interest rate spread			2.89		

	Six Months Ended June 30,				
	2001			2000	
(Dollars in Thousands)	Average Balance	Interest	Average Yield/ Rate	Average Balance	Interest
Interest-earning assets:					
Loans	$10,119,289	$416,582	8.23%	$ 9,263,800	$359,118
Mortgage-backed securities	6,706	215	6.41	19,420	652
Investment securities	466,097	14,404	6.23	322,682	10,445
Total interest-earning assets	10,592,092	431,201	8.14	9,605,902	370,215
Non-interest-earning assets	358,203			342,854	
Total assets	$10,950,295			$ 9,948,756	
Transaction accounts:					
Non-interest-bearing checking .	$ 271,308	$ --	-- %	$ 195,866	$ --
Interest-bearing checking (1) .	402,707	1,132	0.57	377,607	1,859

Money market	89,610	1,254	2.82	90,662	1,280
Regular passbook	821,264	13,943	3.42	813,646	14,426
Total transaction accounts ..	1,584,889	16,329	2.08	1,477,781	17,565
Certificates of deposit	6,988,021	212,858	6.14	5,463,277	153,887
Total deposits	8,572,910	229,187	5.39	6,941,058	171,452
Borrowings	1,478,807	43,524	5.94	2,235,113	66,353
Capital securities	120,000	6,082	10.14	120,000	6,082
Total deposits, borrowings and capital securities	10,171,717	278,793	5.53	9,296,171	243,887
Other liabilities	128,837			97,915	
Stockholders' equity	649,741			554,670	
Total liabilities and stockholders' equity	$10,950,295			$ 9,948,756	
Net interest income/interest rate spread		$152,408	2.61%		$126,328
Excess of interest-earning assets over deposits, borrowings and capital securities	$ 420,375			$ 309,731	
Effective interest rate spread			2.88		

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 June 30, 2001 Versus 2000 Changes Due To				
(In Thousands)	Volume	Rate	Rate/ Volume	Net	Volume
Interest income:					
Loans	$ 9,273	$ 7,525	$ 374	$ 17,172	$ 33,164
Mortgage-backed securities	(206)	(23)	16	(213)	(427)
Investment securities	2,982	(931)	(475)	1,576	4,595
Change in interest income	12,049	6,571	(85)	18,535	37,332

Interest expense:					
Transaction accounts:					
Interest-bearing checking (1) .	58	(452)	(29)	(423)	124
Money market	--	--	--	--	(17)
Regular passbook	638	(162)	(14)	462	148
Total transaction accounts ..	696	(614)	(43)	39	255
Certificates of deposit	21,193	2,337	598	24,128	42,522
Total interest-bearing deposits	21,889	1,723	555	24,167	42,777
Borrowings	(16,912)	(2,386)	985	(18,313)	(22,594)
Capital securities	--	--	--	--	--
Change in interest expense	4,977	(663)	1,540	5,854	20,183
Change in net interest income	$ 7,072	$ 7,234	$ (1,625)	$ 12,681	$ 17,149

PROVISION FOR LOAN LOSSES

Provision for loan losses was $0.4 million in the current quarter, down from $0.9 million in the second quarter of 2000. For the first six months of 2001, provision for loan losses was $0.5 million, compared to $1.7 million in the year-ago period. 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 30.

OTHER INCOME

Our total other income was $22.3 million in the second quarter of 2001, up $12.8 million from a year ago primarily due to:

- an $8.2 million increase in net gains from sales of loans and mortgage-backed securities; and
- a $7.1 million increase in loan and deposit related fees.

Those increases were partially offset by a $2.4 million addition to the valuation allowance for mortgage servicing rights that appears within the category of loan servicing fees. For the first six months of 2001, total other income was $28.2 million, down $2.7 million from a year ago, of which $9.8 million was attributable to the year-ago pre-tax gain from the sale of our indirect automobile finance subsidiary. Below is a further discussion of the major other income categories.

Loan and Deposit Related Fees

Loan and deposit related fees totaled $14.1 million in the second quarter of 2001, up $7.1 million from a year ago. Our loan related fees accounted for $5.7 million of the increase between second quarters, of which $4.9 million represented higher loan prepayment fees. Our deposit related fees increased by $1.4 million or 44.5%, primarily due to higher fees from our checking accounts. For the six months of 2001, loan and deposit related fees totaled $24.4 million, up $11.5 million from the same period of 2000.

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

(In Thousands)	Three Months Ended June 30, 2001	March 31, 2001	December 31, 2000	September 30, 2000	June 30, 2000
Loan related fees:					
Prepayment fees	$ 7,455	$ 4,525	$ 3,899	$ 3,043	$ 2,604
Other fees	2,251	1,779	1,513	1,329	1,338
Deposit related fees:					
Automated teller machine fees	1,650	1,533	1,618	1,566	1,362
Other fees	2,780	2,393	2,270	2,021	1,703
Total loan and deposit related fees	$14,136	$10,230	$ 9,300	$ 7,959	$ 7,007

Real Estate and Joint Ventures Held for Investment

Income from our real estate and joint ventures held for investment in the second quarter of 2001 was virtually unchanged from $0.7 million a year ago. Our net gains on sales of joint ventures declined by $1.1 million and income from real estate operations declined by $0.4 million due to fewer properties being owned. These decreases were offset by a $1.4 million decline in the provision for losses on real estate and joint ventures. For the first six months of 2001, income from real estate and joint ventures held for investment totaled $1.7 million, down $2.1 million from the same period of 2000.

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

(In Thousands)	Three Months End June 30, 2001	March 31, 2001	December 31, 2000	Sep
Operations, net:				
Rental operations, net of expenses	$ 452	$ 508	$ 309	$
Equity in net income from joint ventures	121	391	169	1
Interest from joint venture advances	152	132	200	
Total operations, net	725	1,031	678	2
Net gains on sales of wholly owned real estate	--	2	303	1
(Provision for) reduction of losses on real estate and joint ventures	(33)	(33)	(36)	
Income from real estate and joint ventures held for investment, net	$ 692	$ 1,000	$ 945	$ 4

Secondary Marketing Activities

Sales of loans and mortgage-backed securities we originated increased to $1.364 billion in the second quarter of 2001 from $467 million a year ago. Net gains associated with these sales totaled $9.0 million in the second quarter of 2001, up from $0.7 million a year ago. The net gains included capitalized mortgage servicing rights of $13.4 million in the second quarter of 2001, compared to $5.5 million a year ago. For the first six months of 2001, net gains on sales of loans and mortgage-backed securities totaled $11.1 million, up from $2.5 million from the same period of 2000.

A loss of $2.9 million was recorded in loan servicing fees from our portfolio of loans serviced for others during the second quarter of 2001, compared to income of $0.3 million a year ago. The loss in the 2001 second quarter reflects a $2.4 million provision to the valuation allowance for mortgage servicing rights due to the continued drop in interest rates which reduced the value associated with custodial deposits. At June 30, 2001, we serviced $5.1 billion of loans for others,

compared to $4.0 billion at December 31, 2000 and $3.5 billion at June 30, 2000. For the first six months of 2001, a loss of $11.1 million was recorded in loan servicing fees, compared to income of $0.6 million from the same period of 2000.

The following table presents a breakdown of the components of our loan servicing fees for the periods indicated.

	Three Months Ended				
(In Thousands)	June 30, 2001	March 31, 2001	December 31, 2000	September 30, 2000	June 3 2000
Income from servicing operations	$ 1,752	$ 2,223	$ 2,718	$ 2,086	$ 1,89
Amortization of MSRs	(2,299)	(2,063)	(1,803)	(1,559)	(1,36
Provision for impairment	(2,351)	(8,345)	(5,028)	(606)	(21
Total loan servicing fees	$(2,898)	$(8,185)	$(4,113)	$ (79)	$ 31

For further information regarding mortgage servicing rights, see Notes To Consolidated Financial Statements--Note (4)--Mortgage Servicing Rights on page 8.

OPERATING EXPENSE

Operating expense totaled $40.1 million in the current quarter, up $7.2 million from the second quarter of 2000. The increase was primarily due to a $7.4 million or 22.7% increase in 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. For the first six months of 2001, operating expenses totaled $77.4 million, up $8.7 million from the same period of 2000.

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

	Three Months Ended			
(In Thousands)	June 30, 2001	March 31, 2001	December 31, 2000	September 3 2000
Salaries and related costs	$ 24,646	$ 23,271	$ 21,743	$ 19,280
Premises and equipment costs	6,042	6,043	5,945	5,837
Advertising expense	1,127	1,176	1,121	980

Professional fees	1,604	577	1,274	537
SAIF insurance premiums and regulatory assessments	741	732	696	683
Other general and administrative expense	5,973	5,339	5,188	4,823
Total general and administrative expense .	40,133	37,138	35,967	32,140
Net operation of real estate acquired in settlement of loans	(106)	(2)	263	221
Amortization of excess of cost over fair value of net assets acquired	114	114	114	115
Total operating expense	$ 40,141	$ 37,250	$ 36,344	$ 32,476

PROVISION FOR INCOME TAXES

Income taxes for the current quarter totaled $24.5 million, resulting in an effective tax rate of 42.3%, compared to $16.7 million and 42.6% for the like quarter of a year ago. For the first six months of 2001, our effective tax rate was 42.3%, compared to 42.6% for the same period of 2000. 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 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				
(In Thousands)	June 30, 2001	March 31, 2001	December 31, 2000	September 30, 2000	June 200
Banking net income	$ 33,619	$ 25,309	$ 22,738	$ 24,080	$ 22,2
Real estate investment net income (loss)	(164)	555	257	2,258	2
Total net income	$ 33,455	$ 25,864	$ 22,995	$ 26,338	$ 22,4

	Six Months Ended Jun	
	2001	200
Banking net income	$ 58,928	$ 48,0
Real estate investment net income	391	1,9
Total net income	$ 59,319	$ 49,9

Banking

Net income from our banking operations for the second quarter of 2001 totaled $33.6 million, up 51.2% from $22.2 million in the second quarter of 2000.

The increase between second quarters primarily reflected higher net interest income and other income. Net interest income increased $12.7 million or 20.1% due to an increase in both our average earning assets and our effective interest rate spread. Other income increased $12.6 million, more than double the year-ago level, due to higher net gains from sales of loans and mortgage-backed securities, and loan and deposit related fees. Also favorably impacting our banking net income was a $0.5 million decline in provision for loan losses. These favorable items were partially offset by an unfavorable change in loan servicing fees and an increase in operating expense. Loan servicing included a $2.4 million addition to the valuation allowance for mortgage servicing rights, while operating expense increased $6.3 million due to higher costs associated with the increased number of branch locations and higher loan origination activity.

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

	Three Months Ended			
(In Thousands)	June 30, 2001	March 31, 2001	December 31, 2000	Septembe 200
Net interest income	$ 76,236	$ 76,134	$ 68,879	$ 67,13
Provision for loan losses	431	52	511	1,00
Other income	21,211	4,683	6,466	7,95
Operating expense	38,863	36,990	35,738	32,21
Net intercompany income	84	97	99	8
Income before income taxes	58,237	43,872	39,195	41,95
Income taxes	24,618	18,599	16,457	17,87
Net income before cumulative effect of change in accounting principle	33,619	25,273	22,738	24,08
Cumulative effect of change in accounting principle, net of income taxes	--	36	--	--
Net income	$ 33,619	$ 25,309	$ 22,738	$ 24,08
AT PERIOD END				
Assets:				
Loans and mortgage-backed securities .	$ 9,981,213	$10,272,222	$10,084,353	$ 9,646,74
Other	837,387	755,324	806,201	715,93
Total assets	10,818,600	11,027,546	10,890,554	10,362,67
Equity	$ 680,719	$ 648,592	$ 624,636	$ 602,62

For the first six months of 2001, our net income from banking totaled $58.9 million, up $10.9 million from the same period a year ago. The sale of our indirect automobile finance subsidiary benefited our year-ago six-month period net income by $5.6 million. Excluding that gain, net income from our banking operations would have increased by $16.5 million or 39.0% from a year ago.

The following table sets forth our banking operational results for the periods indicated.

	Six Months Ended June 30	
(In Thousands)	2001	2000
Net interest income	$152,370	$126,216
Provision for loan losses	483	1,733
Other income:		
Gain on sale of subsidiary	--	9,762
All other	25,894	17,225
Operating expense	75,853	68,042
Net intercompany income	181	215
Income before income taxes	102,109	83,643
Income taxes	43,217	35,639
Net income before cumulative effect of change in accounting principle	58,892	48,004
Cumulative effect of change in accounting principle, net of income taxes	36	--
Net income (1)	$ 58,928	$ 48,004

Real Estate Investment

Our real estate investment operations recorded a loss of $0.2 million in the second quarter of 2001, compared to net income of $0.2 million in the year-ago quarter. The decline was primarily attributed to higher operating expenses due to litigation matters associated with certain joint venture partners.

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

	Three Months Ended			
(In Thousands)	June 30, 2001	March 31, 2001	December 31, 2000	September 2000
Net interest income	$ 10	$ 28	$ 58	$ 73
Other income	1,072	1,268	1,079	4,112
Operating expense	1,278	260	606	260
Net intercompany expense	84	97	99	83
Income (loss) before income taxes (benefit)	(280)	939	432	3,842
Income taxes (benefit)	(116)	384	175	1,584
Net income (loss)	$ (164)	$ 555	$ 257	$ 2,258

AT PERIOD END:				
Assets:				
Investment in real estate and joint ventures	$ 19,950	$ 18,690	$ 17,641	$ 15,851
Other	1,673	3,337	3,584	6,347
Total assets	21,623	22,027	21,225	22,198
Equity	$ 18,307	$ 18,471	$ 17,916	$ 17,659

Our investment in real estate and joint ventures amounted to $20 million at June 30, 2001, compared to $18 million at December 31, 2000 and $39 million at June 30, 2000.

For the first six months of 2001, our net income from real estate investment operations totaled $0.4 million, down from $1.9 million from the same period a year ago.

The following table sets forth our real estate investment operational results for the periods indicated.

	Six Months Ended June 30,	
(In Thousands)	2001	2000
Net interest income	$ 38	$ 112
Other income	2,340	3,957
Operating expense	1,538	607
Net intercompany expense .	181	215
Income before income taxes	659	3,247
Income taxes	268	1,333
Net income	$ 391	$1,914

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 30.

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FINANCIAL CONDITION

LOANS AND MORTGAGE-BACKED SECURITIES

Total loans and mortgage-backed securities, including those we hold for sale, decreased $291 million during the second quarter to a total of $10.0 billion or 92.2% of assets at June 30, 2001. The decrease represents a lower level of single family loans held for investment, which declined $210 million during the quarter as prepayments exceeded originations. Given the low interest rate environment and borrower preference for fixed rate loans, our annualized prepayment speed in the current quarter was a record 44%, compared to 18% a year ago.

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

(In Thousands)	Three Months Ended June 30, 2001	March 31, 2001	December 31, 2000	September 2000
Loans originated for investment:				
Residential one-to-four units:				
Adjustable	$ 814,696	$ 636,988	$ 887,064	$ 382,82
Fixed	10,849	4,117	2,713	3,89
Other	43,492	28,964	57,901	82,34
Total loans originated for investment	869,037	670,069	947,678	469,06
Loans originated for sale (1)	1,296,877	796,801	335,726	482,59
Total loans originated	$2,165,914	$1,466,870	$1,283,404	$ 951,66

Originations of residential one-to-four unit loans totaled a record $2.122 billion in the second quarter of 2001, of which $826 million were for portfolio and $1.297 billion were for sale. This was 47.6% above the $1.438 billion we originated in the first quarter of 2001 and 52.7% above the $1.390 billion we originated in the year-ago second quarter. Of the current quarter originations for portfolio, $110 million represented originations of subprime credits as part of our continuing strategy to enhance the portfolio's net yield. During the current quarter, 72% of our residential one-to-four unit originations represented refinancing transactions. This is similar to the previous quarter level but up from 34% in the year-ago second quarter. In addition to single family loans, we originated $43 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.

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At June 30, 2001, $7.0 billion of the adjustable rate mortgages in our loan portfolio were subject to negative amortization of which $183 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 $1.364 billion of loans in the second quarter of 2001, compared to $597 million in the previous quarter and $467 million in the second quarter of 2000. All were secured by residential one-to-four unit property, and at June 30, 2001, loans held for sale totaled $377 million.

At June 30, 2001, our unfunded loan application pipeline totaled $1.522 billion. Within that pipeline, we had commitments to borrowers for short-term interest rate locks of $647 million, of which $320 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 of credit of $82 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.

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

	Three Month		
(In Thousands)	June 30, 2001	March 31, 2001	December 2000
INVESTMENT PORTFOLIO			
Loans originated:			
Loans secured by real estate:			
Residential one-to-four units:			
Adjustable	$ 620,539	$ 501,945	$ 675,9
Adjustable - subprime	106,148	135,043	210,9
Total adjustable	726,687	636,988	886,8
Fixed	7,455	4,117	2,3
Fixed - subprime	3,394	--	--
Residential five or more units:			
Adjustable	--	--	--
Fixed	125	--	1
Total residential	737,661	641,105	889,3
Commercial real estate	--	--	--
Construction	23,154	18,888	30,7
Land	6,219	--	9,7
Non-mortgage:			
Commercial	4,970	165	7,0

Automobile	1,502	2,091	4,4
Other consumer	7,522	7,570	5,7
Total loans originated	781,028	669,819	947,0
Real estate loans purchased:			
One-to-four units	88,009	--	4
One-to-four units - subprime	--	--	2
Other (1)	--	250	--
Total real estate loans purchased	88,009	250	6
Total loans originated and purchased	869,037	670,069	947,6
Loan repayments	(1,095,547)	(705,116)	(621,1
Other net changes (2)	5,813	32,585	28,5
Net increase (decrease) in loans held for investment	(220,697)	(2,462)	355,0
SALE PORTFOLIO			
Residential, one-to-four units:			
Originated whole loans	1,296,270	796,216	333,9
Originated whole loans - subprime	--	--	7
Loans purchased	607	585	9
Loans transferred from (to) the investment portfolio	(787)	(2,392)	(1,7
Originated whole loans sold	(292,552)	(134,352)	(75,2
Loans exchanged for mortgage-backed securities	(1,071,840)	(462,744)	(167,6
Other net changes	(649)	(3,179)	(6,3
SFAS 133 capitalized basis adjustment (3)	(753)	558	--
Net increase (decrease) in loans held for sale	(69,704)	194,692	84,7
Mortgage-backed securities, net:			
Received in exchange for loans	1,071,840	462,744	167,6
Sold	(1,071,840)	(462,744)	(167,6
Repayments	(647)	(4,417)	(2,4
Other net changes	39	56	2
Net decrease in mortgage-backed securities available for sale	(608)	(4,361)	(2,2
Net increase (decrease) in loans held for sale and mortgage-backed securities available for sale	(70,312)	190,331	82,5
Total net increase (decrease) in loans and mortgage-backed securities	$ (291,009)	$ 187,869	$ 437,6

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

(In Thousands)	June 30, 2001	March 31, 2001	December 3 2000
INVESTMENT PORTFOLIO			
Loans secured by real estate:			
Residential one-to-four units:			

Adjustable	$ 7,097,270	$ 7,215,128	$ 7,200,40
Adjustable - subprime	1,683,302	1,748,715	1,726,52
Fixed	408,757	437,197	454,83
Fixed - subprime	18,256	16,941	17,38
Total residential one-to-four units	9,207,585	9,417,981	9,399,15
Residential five or more units:			
Adjustable	13,359	13,462	14,20
Fixed	5,464	5,453	5,25
Commercial real estate:			
Adjustable	47,236	47,583	37,37
Fixed	110,513	114,586	127,23
Construction	99,261	96,564	118,16
Land	21,283	21,230	26,88
Non-mortgage:			
Commercial	21,648	21,312	21,72
Automobile	32,594	36,590	39,61
Other consumer	56,096	58,610	60,65
Total loans held for investment	9,615,039	9,833,371	9,850,24
Increase (decrease) for:			
Undisbursed loan funds	(59,940)	(59,206)	(72,32
Net deferred costs and premiums	78,621	80,010	79,10
Allowance for losses	(34,301)	(34,059)	(34,45
Total loans held for investment, net	9,599,419	9,820,116	9,822,57
SALE PORTFOLIO, NET			
Loans held for sale:			
Residential one-to-four units	376,755	445,706	251,01
Residential one-to-four units - subprime	--	--	55
SFAS 133 capitalized basis adjustment (1)	(195)	558	--
Total loans held for sale	376,560	446,264	251,57
Mortgage-backed securities available for sale:			
Adjustable	5,234	5,835	6,05
Fixed	--	7	4,15
Total mortgage-backed securities available for sale	5,234	5,842	10,20
Total loans held for sale and mortgage-backed securities available for sale	381,794	452,106	261,77
Total loans and mortgage-backed securities ..	$ 9,981,213	$ 10,272,222	$ 10,084,35

We carry loans for sale at the lower of cost or market. At June 30, 2001, no valuation allowance was required as the market value exceeded book value on an aggregate basis.

At June 30, 2001, our residential one-to-four units subprime portfolio consisted of approximately 75% "A-" credit, 21% "B" credit and 4% "C" credit loans. At June 30, 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 June 30, 2001, reflected an unrealized loss of $30,000. 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 June 30, 2001, our deposits totaled $9.0 billion, up $1.8 billion or 24.0% from the year-ago quarter end and up $957 million or 11.8% from year-end 2000. Compared to the year-ago period, our certificates of deposit increased $1.4 billion or 24.2% and our transaction accounts--i.e., checking, regular passbook and money market--increased $339 million or 23.1%. Within transaction accounts, our regular passbook accounts increased $183 million or 22.7% and our total checking accounts (non-interest and interest bearing) increased $151 million or 26.2%.

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

(Dollars in Thousands)	June 30, 2001 Weighted Average Rate	June 30, 2001 Amount	March 31, 2001 Weighted Average Rate	March 31, 2001 Amount	December 31, 2000 Weighted Average Rate	December 31, 2000 Amount	September 30 Weighted Average Rate
Transaction accounts:							
Non-interest-bearing checking	-- %	$ 328,338	-- %	$ 335,404	-- %	$ 244,311	-- %
Interest-bearing checking (1)	0.42	401,126	0.42	416,636	0.78	395,640	0.78
Money market	2.79	89,949	2.87	91,733	2.88	89,408	2.87
Regular passbook	3.44	986,488	3.38	807,503	3.41	754,127	3.42
Total transaction accounts	2.11	1,805,901	1.92	1,651,276	2.12	1,483,486	2.18
Certificates of deposit:							
Less than 3.00%	2.48	27,473	2.14	7,620	2.41	6,357	2.41
3.00-3.49	3.36	8,342	3.45	26	3.45	25	3.45
3.50-3.99	3.83	82,191	3.81	20,748	3.97	384	3.82
4.00-4.49	4.29	387,442	4.38	7,279	4.19	26,916	4.23
4.50-4.99	4.74	691,800	4.72	293,442	4.82	80,844	4.83
5.00-5.99	5.50	2,791,697	5.62	2,288,745	5.71	1,901,166	5.69
6.00-6.99	6.59	3,233,032	6.64	4,424,756	6.63	4,558,730	6.58
7.00 and greater	7.03	12,186	7.03	14,383	7.02	24,781	7.02
Total certificates of deposit	5.82	7,234,163	6.21	7,056,999	6.33	6,599,203	6.22
Total deposits.....	5.08%	$9,040,064	5.40%	$8,708,275	5.56%	$8,082,689	5.44%

BORROWINGS

During the 2001 second quarter, our borrowings decreased $564 million to $893 million, due to a decrease in FHLB advances. This followed a decrease of $521 million during the first quarter of 2001.

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

(Dollars in Thousands)	June 30, 2001	March 31, 2001	December 31, 2000	Sep
Federal Home Loan Bank advances	$ 892,670	$1,457,046	$1,978,348	$1,8
Other borrowings	94	145	224	
Total borrowings	$ 892,764	$1,457,191	$1,978,572	$1,8
Weighted average rate on borrowings during the period	5.67%	6.14%	6.34%	
Total borrowings as a percentage of total assets	8.25	13.21	18.16	

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 second 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 June 30, 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.

(Dollars in Thousands)		June 30, 2001 Within 6 Months	7 - 12 Months	2 - 5 Years	6 - 10 Years
Interest-earning assets:					
Investment securities and FHLB stock ..	(1)	$ 288,273	$ 36,283	$130,396	$ 6
Loans and mortgage-backed securities: .	(2)				
Loans secured by real estate:					
Residential:					
Adjustable		8,315,833	238,787	291,575	--
Fixed		414,476	32,435	178,564	106,90
Commercial real estate		49,632	17,198	81,151	3,60
Construction		50,691	--	--	--
Land		13,557	9	67	79
Non-mortgage loans:					
Commercial		14,721	--	--	--
Consumer		62,980	6,446	18,428	--
Mortgage-backed securities		5,234	--	--	--
Total loans and mortgage-backed securities		8,927,124	294,875	569,785	111,31
Total interest-earning assets		$9,215,397	$ 331,158	$700,181	$ 111,38
Transaction accounts:					
Non-interest-bearing checking		$ 328,338	--	--	--
Interest-bearing checking	(3)	401,126	--	--	--
Money market	(4)	89,949	--	--	--
Regular passbook	(4)	986,488	--	--	--
Total transaction accounts		1,805,901	--	--	--
Certificates of deposit	(1)	5,242,261	1,853,536	138,366	--
Total deposits		7,048,162	1,853,536	138,366	--
Borrowings		215,549	74,258	172,957	430,00
Capital securities		--	--	--	--
Total deposits, borrowings and capital securities		$7,263,711	$ 1,927,794	$311,323	$ 430,00
Excess (shortfall) of interest-earning assets over deposits, borrowings and capital securities		$1,951,686	$(1,596,636)	$388,858	$(318,62
Cumulative gap		1,951,686	355,050	743,908	425,28
Cumulative gap - as a % of total assets:					
June 30, 2001		18.03%	3.28%	6.87%	3.9
December 31, 2000		28.66	7.13	5.94	3.1
June 30, 2000		32.57	14.05	5.23	2.4

Our six-month gap at June 30, 2001 was a positive 18.03%. 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 28.66% at December 31, 2000 and 32.57% at June 30, 2000. We continue to pursue our strategy of emphasizing the origination of adjustable rate mortgages. For the twelve months ended June 30, 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 June 30, 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 June 30, 2000. At June 30, 2001, loans held for investment and mortgage-backed securities with adjustable interest rates represented 90% of those portfolios. During the second 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 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 June 30, 2001, $9.2 billion or 92% 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 $9.1 billion or 93% at June 30, 2000.

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

	June 30, 2001	March 31, 2001	December 31, 2000	September 30, 2000
Weighted average yield:				
Loans and mortgage-backed securities	8.24%	8.56%	8.45%	8.40%
Federal Home Loan Bank stock	6.00	5.51	5.52	5.52
Investment securities	5.54	6.00	6.45	6.42
Interest-earning assets yield	8.12	8.46	8.36	8.32
Weighted average cost:				
Deposits	5.08	5.40	5.56	5.44
Borrowings:				
Federal Home Loan Bank advances ..	5.36	5.94	6.26	6.37
Other borrowings	7.88	7.88	8.12	7.88
Total borrowings	5.36	5.94	6.26	6.37
Capital securities	10.00	10.00	10.00	10.00
Combined funds cost	5.16	5.53	5.75	5.68
Interest rate spread	2.96%	2.93%	2.61%	2.64%

The period-end weighted average yield on our loan portfolio decreased to 8.24% at June 30, 2001, down from 8.45% at December 31, 2000 , but up from 8.03% at June 30, 2000. At June 30, 2001, our adjustable rate mortgage portfolio of single family residential loans, including mortgage-backed securitites, totaled $8.8 billion with a weighted average rate of 8.27%, compared to $9.0 billion with a weighted average rate of 8.47% at December 31, 2000 and $8.7 billlion with a weighted average rate of 8.00% at June 30, 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 only $1 million to $60 million or 0.55% of total assets. This increase was primarily due to a rise in residential non-performers of $2 million, which included a $2 million decline in residential subprime 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.

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

(Dollars in Thousands)	June 30, 2001	March 31, 2001	December 31, 2000	S
Non-accrual loans:				
Residential one-to-four units	$22,494	$16,965	$20,746	
Residential one-to-four units - subprime	25,737	26,353	22,296	
Other	3,054	3,367	1,708	
Total non-accrual loans	51,285	46,685	44,750	
Troubled debt restructure - below market rate (1) ...	204	205	206	
Real estate acquired in settlement of loans	8,366	11,634	9,942	
Repossessed automobiles	37	15	76	
Total non-performing assets	$59,892	$58,539	$54,974	
Allowance for loan losses:				
Amount	$34,301	$34,059	$34,452	
As a percentage of non-performing loans	66.62%	72.64%	76.63%	
Non-performing assets as a percentage of total assets	0.55	0.53	0.50	

Delinquent Loans

During the 2001 second quarter, our delinquencies as a percentage of total loans outstanding increased from 0.73% to 0.81% and were above the 0.51% of a year ago. The increase primarily occurred in both of our residential one-to-four unit categories.

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

June 30, 2001

(Dollars in Thousands)	30-59 Days	60-89 Days	90+ Days (1)	Total	30-59 Days	6 D
Loans secured by real estate:						
Residential:						
One-to-four units	$15,190	$ 7,262	$17,291	$39,743	$14,166	$
One-to-four units - subprime ...	11,402	6,513	20,772	38,687	11,223	
Five or more units	--	--	248	248	--	
Commercial real estate	--	--	--	--	--	
Construction	--	--	--	--	--	
Land	--	--	--	--	--	
Total real estate loans	26,592	13,775	38,311	78,678	25,389	
Non-mortgage:						
Commercial	--	--	1,290	1,290	--	
Automobile	112	63	32	207	230	
Other consumer	287	28	185	500	189	
Total loans	$26,991	$13,866	$39,818	$80,675	$25,808	$
Delinquencies as a percentage of total loans	0.27%	0.14%	0.40%	0.81%	0.25%	

	December 31, 2000				Se	
Loans secured by real estate:						
Residential:						
One-to-four units	$12,400	$ 8,611	$15,246	$36,257	$14,970	$
One-to-four units - subprime ...	7,300	7,658	14,427	29,385	7,701	
Five or more units	--	--	--	--	--	
Commercial real estate	--	--	--	--	--	
Construction	--	--	--	--	--	
Land	--	--	--	--	--	
Total real estate loans	19,700	16,269	29,673	65,642	22,671	
Non-mortgage:						
Commercial	--	--	--	--	--	
Automobile	393	26	151	570	356	
Other consumer	98	29	246	373	200	
Total loans	$20,191	$16,324	$30,070	$66,585	$23,227	$
Delinquencies as a percentage of total loans	0.20%	0.16%	0.30%	0.66%	0.24%	

	June 30, 2000			
Loans secured by real estate:				
Residential:				
One-to-four units	$ 7,519	$4,970	$14,805	$27,294
One-to-four units - subprime ...	6,270	4,590	11,054	21,914
Five or more units	--	--	--	--
Commercial real estate	--	--	--	--
Construction	--	--	--	--
Land	--	--	--	--
Total real estate loans	13,789	9,560	25,859	49,208

Non-mortgage:				
Commercial	--	--	--	--
Automobile	158	--	6	164
Other consumer	372	30	208	610
Total loans	$14,319	$9,590	$26,073	$49,982
Delinquencies as a percentage of total loans	0.15%	0.10%	0.26%	0.51%

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 June 30, 2001, $38 million at December 31, 2000 and $37 million at June 30, 2000.

Our provision for loan losses was $0.4 million in the current quarter and exceeded our net loan charge-offs by $0.2 million resulting in an increase in the allowance for loan losses to $34.3 million at June 30, 2001. The current quarter allowance increase reflected an increase of $0.4 million in allocated allowances to $5.1 million due to an increase in bankruptcies. General valuation allowances declined by $0.2 million to $26.4 million due to declines in various categories of our loan portfolio. There was no change in the unallocated allowance of $2.8 million. Since year-end 2000, our allowance for loan losses declined by $0.2 million, as general valuation allowances declined by $0.6 million, partially offset by a $0.4 million increase in allocated allowances.

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

	Three Months Ended				
(In Thousands)	June 30, 2001	March 31, 2001	December 31, 2000	September 30, 2000	June 20
Balance at beginning of period	$ 34,059	$ 34,452	$ 34,014	$ 33,237	$ 32,5

Provision	431	52	511	1,007	9
Charge-offs	(326)	(508)	(346)	(234)	(2
Recoveries	137	63	273	4	
Balance at end of period	$ 34,301	$ 34,059	$ 34,452	$ 34,014	$ 33,2

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

(Dollars in Thousands)	Three Months Ended June 30, 2001	March 31, 2001	December 31, 2000	Septem 2000
GROSS LOAN CHARGE-OFFS				
Loans secured by real estate:				
Residential:				
One-to-four units	$ 115	$ 268	$ 69	$ 153
One-to-four units - subprime	92	136	136	21
Five or more units	--	--	--	--
Commercial real estate	--	--	--	--
Construction	--	--	--	--
Land	--	--	--	--
Non-mortgage:				
Commercial	--	--	--	--
Automobile	72	48	98	--
Other consumer	47	56	43	60
Total gross loan charge-offs	326	508	346	234
GROSS LOAN RECOVERIES				
Loans secured by real estate:				
Residential:				
One-to-four units	121	59	19	--
One-to-four units - subprime	5	--	--	--
Five or more units	--	--	--	--
Commercial real estate	1	--	250	--
Construction	--	--	--	--
Land	--	--	--	--
Non-mortgage:				
Commercial	--	--	--	--
Automobile	4	--	--	--
Other consumer	6	4	4	4
Total gross loan recoveries	137	63	273	4
NET LOAN CHARGE-OFFS				
Loans secured by real estate:				
Residential:				
One-to-four units	(6)	209	50	153
One-to-four units - subprime	87	136	136	21
Five or more units	--	--	--	--
Commercial real estate	(1)	--	(250)	--
Construction	--	--	--	--
Land	--	--	--	--
Non-mortgage:				

Commercial	--	--	--	--
Automobile	68	48	98	--
Other consumer	41	52	39	56
Total net loan charge-offs	$ 189	$ 445	$ 73	$ 230
Net loan charge-offs as a percentage of average loans	0.01%	0.02%	-- %	0.01

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

(Dollars in Thousands)	June 30, 2001 Allowance	June 30, 2001 Gross Loan Portfolio Balance	June 30, 2001 Allowance Percentage To Loan Balance	March 31, 2001 Allowance	March 31, 2001 Gross Loan Portfolio Balance	March 31, 2001 Allowance Percentage to Loan Balance	All
Loans secured by real estate:							
Residential:							
One-to-four units	$15,139	$7,506,027	0.20%	$14,613	$7,652,325	0.19%	$1
One-to-four units - subprime	10,826	1,701,558	0.64	11,057	1,765,656	0.63	1
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%	$3

	September 30, 2000			June 30, 2000		
Loans secured by real estate:						
Residential:						
One-to-four units	$15,143	$7,393,275	0.20%	$14,622	$7,442,407	0.20%
One-to-four units - subprime	9,946	1,652,462	0.60	9,862	1,695,352	0.58
Five or more units	148	19,728	0.75	175	19,900	0.88
Commercial real estate ...	2,930	164,305	1.78	2,690	147,752	1.82
Construction	1,412	120,179	1.17	1,433	121,602	1.18
Land	325	26,294	1.24	463	37,222	1.24
Non-mortgage:						
Commercial	287	23,454	1.22	283	24,511	1.15
Automobile	234	40,303	0.58	203	38,935	0.52
Other consumer	789	60,362	1.31	706	56,627	1.25
Not specifically allocated ..	2,800	--	--	2,800	--	--
Total loans held for						

investment	$34,014	$9,500,362	0.36%	$33,237	$9,584,308	0.35%

At June 30, 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 second quarter of 2001, total interest recognized on the impaired loan portfolio was $0.4 million, increasing the year-to-date total to $0.9 million.

The following table is a summary of the activity in our allowance for loan losses associated with impaired loans during 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)	June 30, 2001	March 31, 2001	December 31, 2000	September 30, 2000	June 30, 2000
Balance at beginning of period	$ 798	$ 800	$ 791	$ 792	$ 795
Provision (reduction)	(16)	(2)	9	(1)	(3)
Charge-offs	--	--	--	--	--
Recoveries	--	--	--	--	--
Balance at end of period	$ 782	$ 798	$ 800	$ 791	$ 792

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.

	Three Months Ended				
(In Thousands)	June 30, 2001	March 31, 2001	December 31, 2000	September 30, 2000	June 30, 2000
Balance at beginning of period	$3,030	$2,997	$2,961	$3,561	$2,088
Provision (reduction)	33	33	36	(600)	1,473
Charge-offs	--	--	--	--	--
Recoveries	--	--	--	--	--
Balance at end of period	$3,063	$3,030	$2,997	$2,961	$3,561

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 second quarter of 2001 were from:

- principal repayments--including prepayments, but excluding refinances of our existing loans--on loans and mortgage-backed securities of $865 million; and
- a net increase in deposits of $332 million.

We used these funds for the following purposes:

- to originate and purchase loans held for investment of $634 million; and
- to paydown our borrowings by $564 million.

At June 30, 2001, the Bank's ratio of regulatory liquidity was 5.4%, compared to 4.3% at December 31, 2000 and 4.1% at June 30, 2000.

Downey currently has liquid assets, including due from Bank--interest bearing balances, of $20 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 $681 million at June 30, 2001, up from $625 million at December 31, 2000 and $577 million at June 30, 2000.

REGULATORY CAPITAL COMPLIANCE

Our core and tangible capital ratios were 6.95% and our risk-based capital ratio was 13.84%. 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 June 30, 2001.

	Tangible Capital		Core Capital	
(Dollars in Thousands)	Amount	Ratio	Amount	Ratio
Stockholder's equity	$776,487		$776,487	
Adjustments:				
Deductions:				
Investment in subsidiary, primarily real estate	(17,687)		(17,687)	
Goodwill	(3,379)		(3,379)	
Non-permitted mortgage servicing rights ..	(4,214)		(4,214)	
Additions:				
Unrealized gains on securities available for sale	(2,394)		(2,394)	
General loss allowance - investment in DSL Service Company	549		549	
Allowance for loan losses, net of specific allowances (1)	--		--	
Regulatory capital	749,362	6.95%	749,362	6.95%
Well capitalized requirement	161,785	1.50 (2)	539,284	5.00
Excess	$587,577	5.45%	$210,078	1.95%

PART II - OTHER INFORMATION

Item 6 - Exhibits and Reports on Form 8-K

(A) Exhibits

(B) Form 8-K filed April 16, 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: August 1, 2001

/s/ Daniel D. Rosenthal

Daniel D. Rosenthal
President and Chief Executive Officer

Date: August 1, 2001

/s/ Thomas E. Prince

Thomas E. Prince
Executive Vice President and Chief Financial Officer