COMMERCIAL FEDERAL CORP
Form 10-K
March 05, 2004
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE YEAR ENDED DECEMBER 31, 2003

Commission File Number: 1-11515

COMMERCIAL FEDERAL CORPORATION

(Exact Name of Registrant as Specified in its Charter)

Nebraska	**47-0658852**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
13220 California Street, Omaha, Nebraska	**68154**
(Address of Principal Executive Offices)	**(Zip Code)**

Registrant s telephone number, including area code: **(402) 554-9200**

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

Common Stock, Par Value $.01 Per Share	**New York Stock Exchange**

Title of Each Class	Name of Each Exchange on Which Registered
Shareholder Rights Plan	**New York Stock Exchange**
7.95% Subordinated Notes due December 2006	**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act: **None**

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is an accelerated filer as defined in Rule 12b-2 of the Securities Exchange Act of 1934. Yes x No ¨

The aggregate market value of the voting stock held by non-affiliates of the registrant, based upon the average high and low sales price of the registrant s common stock as quoted on the New York Stock Exchange on June 30, 2003, the last business day of the registrant s most recently completed second fiscal quarter, was $782,920,450. As of March 1, 2004, there were issued and outstanding 40,916,744 shares of the registrant s common stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2004 Annual Meeting of Stockholders See Part III.

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PART I

ITEM 1. BUSINESS

Forward Looking Statements

This document contains certain statements that are not historical fact but are forward-looking statements that involve inherent risks and uncertainties. Management cautions readers that a number of important factors could cause actual results to differ materially from those in the forward looking statements. Factors that might cause a difference include, but are not limited to: fluctuations in interest rates, inflation, the effect of regulatory or government legislative changes, expected cost savings and revenue growth not fully realized, the progress of strategic initiatives and whether realized within expected time frames, general economic conditions, adequacy of allowance for loan losses, costs or difficulties associated with restructuring initiatives, technology changes and competitive pressures in the geographic and business areas where Commercial Federal Corporation conducts its operations. These forward-looking statements are based on management s current expectations. Actual results in future periods may differ materially from those currently expected because of various risks and uncertainties.

General

Commercial Federal Corporation (the parent company) was incorporated in the state of Nebraska on August 18, 1983, as a unitary non-diversified savings and loan holding company. References in this document to the Corporation are to Commercial Federal Corporation and its consolidated subsidiaries and references to the Bank are to Commercial Federal Bank, a Federal Savings Bank, and its consolidated subsidiaries. The primary purpose of the parent company was to acquire all of the capital stock of Commercial Federal Bank, a Federal Savings Bank, in connection with the Bank s 1984 conversion from mutual to stock ownership. A secondary purpose of the organizational structure was to provide the structure to expand and diversify the Corporation s financial services to activities allowed by regulation for a unitary savings and loan holding company. The general offices of the Corporation are located at 13220 California Street, Omaha, Nebraska 68154.

The primary subsidiary of the parent company is the Bank. The Bank was originally chartered in 1887 and converted to a federally chartered mutual savings and loan association in 1972. On December 31, 1984, the Bank completed its conversion from mutual to stock ownership and became a wholly-owned subsidiary of the parent company. On August 27, 1990, the Bank s federal charter was amended from a savings and loan to a federal savings bank.

The assets of the parent company, on an unconsolidated basis, substantially consist of 100% of the Bank s common stock. The parent company has no significant independent source of income, and therefore depends almost exclusively on cash distributions from the Bank to meet its funding requirements. During the calendar year ended December 31, 2003, the parent company incurred interest expense on its subordinated extendible notes, junior subordinated debentures and unsecured term notes. Interest was payable monthly on the subordinated extendible notes, and quarterly on the junior subordinated debentures and the unsecured term note. For additional information on the debt of the Corporation see Note 12 Other Borrowings to the Consolidated Financial Statements that are filed under Item 8 of this Form 10-K Annual Report for the year ended December 31, 2003 (the Report).

The parent company began repurchasing its common stock in April 1999. For the year ended December 31, 2003, the parent company purchased and cancelled 3,992,100 shares of its common stock at a cost of $95.5 million. As of December 31, 2003, since the inception of the repurchase

program in April 1999, the parent company has purchased and canceled 20,751,300 shares of its common stock, or 34.0% of the outstanding common stock at inception, at a cost of $451.1 million. The parent company also pays operating expenses

primarily for shareholder and stock related expenditures such as the annual report, proxy, corporate filing fees and assessments and certain costs directly attributable to the parent company. In addition, common stock cash dividends totaling $17.9 million, or $.415 per common share, were declared during the year ended December 31, 2003.

The Bank pays cash distributions to the parent company on a periodic basis primarily to cover the amount of the principal and interest payments on the parent company s debt, to fund the parent company s common stock repurchases and to repay the parent company for the common stock cash dividends paid to the parent company s stockholders. During the year ended December 31, 2003, the Corporation received cash distributions totaling $125.0 million from the Bank. See Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) Liquidity and Capital Resources under Item 7 of this Report for additional information.

The Bank operates as a federally chartered savings institution with deposits insured by the Savings Association Insurance Fund (SAIF) and the Bank Insurance Fund (BIF) both administered by the Federal Deposit Insurance Corporation (FDIC). The Bank is a community banking institution offering commercial and consumer banking services including mortgage loan origination and servicing, commercial and industrial lending, small business banking, construction lending, cash management, deposit services, brokerage and insurance services, and Internet banking.

At December 31, 2003, the Corporation had assets of $12.2 billion and stockholders equity of $755.4 million, and operated 192 branches located in Colorado (45), Nebraska (42), Iowa (40), Kansas (27), Oklahoma (19), Missouri (13) and Arizona (6). The Bank is one of the largest retail financial institutions in the Midwest and, based upon total assets at December 31, 2003, the Corporation was the 11th largest publicly-held thrift institution in the United States. In addition, the Corporation serviced a loan portfolio totaling $15.0 billion at December 31, 2003, with approximately $11.4 billion in loans serviced for third parties and $3.6 billion in loans serviced for the Bank. See MD&A Overview of this Report for additional information.

The Corporation s business and earnings are sensitive to general business and economic conditions in the United States and, in particular, the Midwestern states where it has significant operations. These conditions include short-term and long-term interest rates, inflation, monetary supply, fluctuations in both debt and equity capital markets, the strength of the national and local economies and consumer spending, borrowing and savings habits. An economic downturn, an increase in unemployment or higher interest rates could decrease the demand for loans and other products and services and result in a deterioration in credit quality, loan performance and collectibility. Higher interest rates also could increase the Corporation s cost to borrow funds and increase the rate the Corporation pays on deposits.

The long-term economic and political effects of terrorism and international hostilities remain uncertain which could hinder further economic recovery and could negatively affect the Corporation s financial condition. Events that could adversely affect the Corporation s business and operating results in other ways presently cannot be predicted. In addition, continued uncertainty in the economy could negatively impact the purchasing and decision making activities of the Corporation s customers. If terrorist activity, international hostilities or other factors cause a further economic decline, the financial condition and operating results of the Corporation could be materially adversely affected.

The Corporation s operations also are significantly affected by the fiscal and monetary policies of the federal government and by the policies of financial institution regulatory authorities, including the Office of Thrift Supervision (OTS), the Board of Governors of the Federal Reserve System and the FDIC. The policies of the Federal Reserve Board impact the Corporation significantly. The Federal Reserve Board regulates the supply of money and credit in the United States. Those policies directly and indirectly influence the rate of

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interest earned on loans and paid on borrowings and interest-bearing deposits and can also affect the value of financial instruments the Corporation holds. Those policies determine to a significant extent the Corporation s cost of funds for lending and investing. Changes in those policies are beyond the Corporation s control and are difficult to predict. Deposit flows and costs of funds are also influenced by interest rates on competing investments and general market rates of interest. Lending activities are affected by the demand for mortgage and commercial financing, consumer loans and other types of loans, which, in turn, are affected by the interest rates at which such financings may be offered, the availability of funds, and other factors, such as the supply of housing for mortgage loans and regional economic situations.

The Bank is a member of the Federal Home Loan Bank (FHLB) of Topeka, which is one of the 12 regional banks comprising the FHLB System. The Bank is further subject to regulations of the Federal Reserve Board, which governs reserves required to be maintained against deposits and certain other matters. As a federally chartered savings bank, the Bank is subject to numerous restrictions on operations and investments imposed by applicable statutes and regulations. See the Regulation section of this Report.

Segment Reporting

The Corporation s operations are aligned into four lines of business for management reporting purposes: Commercial Banking, Retail Banking, Mortgage Banking and Treasury. This business operation alignment allows management to make well-informed operating decisions, to focus resources to benefit both the Corporation and its customers, and to assess performance and products on a continuous basis. See MD&A Operating Results by Segment and Note 21 Segment Information for additional information.

Regulatory Capital Compliance

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Corporation s financial position and results of operations. The regulations require the Bank to meet specific capital adequacy guidelines. Prompt corrective action provisions contained in the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) require specific capital ratios to be considered well-capitalized. At December 31, 2003, the Bank exceeded the minimum requirements for the well-capitalized category. As of December 31, 2003, the most recent notification from the OTS categorized the Bank as well-capitalized under the regulatory framework for prompt corrective action provisions under FDICIA. There are no conditions or events since such notification that management believes have changed the Bank s classification. See Regulation Regulatory Capital Requirements and Note 16 Regulatory Capital of this Report.

Supervisory Goodwill Lawsuits

On September 12, 1994, the Bank and the Corporation commenced litigation relating to supervisory goodwill against the United States government (the Government) in the United States Court of Federal Claims seeking to recover monetary relief for the Government s refusal to honor certain contracts that it had entered into with the Bank. The suit alleged that such governmental action constituted a breach of contract and an unlawful taking of property by the Government without just compensation or due process in violation of the Constitution of the United States. On March 25, 1998, the Corporation filed a motion for summary judgment and the Government filed a cross motion for summary judgment on the question of liability for breach of contract. On March 24, 2003, the Corporation received an order from the United States Court of Federal Claims denying its motion for summary judgment seeking to establish liability for breach of contract and granting the Government s cross motion concluding that there was no contract with respect to the Corporation s 1987 acquisition of Empire Savings Building and Loan (Empire). In the litigation, the Corporation alleged that with respect to its acquisition of Empire, the Federal Home Loan Bank Board promised that $190.0

million of goodwill (the amount by which Empire s liabilities exceeded its assets) would be included in the Bank s regulatory capital as well as

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the $60.0 million of preferred stock issued by the Bank to fund the acquisition of Empire. The March 2003 order from the United States Court of Federal Claims also granted the Corporation s motion for summary judgment and denied the Government s cross-motion for summary judgment on the question of liability for breach of contract with respect to the Corporation s acquisition of the savings deposits of Territory Savings and Loan Association (Territory) whereby the Bank accepted a five year $20.0 million promissory note from the Federal Savings and Loan Insurance Corporation (FSLIC) as part of the FSLIC s payment for the Bank s assumption of the savings deposits. The United States Court of Federal Claims agreed with the Corporation that the FSLIC had promised that the Bank could include the promissory note in its regulatory capital. On July 22, 2003, the United States Court of Federal Claims issued its ruling dismissing the Corporation s complaint and the Corporation and the Bank determined not to appeal this ruling. As a result, the litigation with respect to the Empire and Territory claims has been terminated with no damages awarded to the Corporation or the Bank.

The Bank also assumed a lawsuit in the merger with Mid Continent Bancshares, Inc. (Mid Continent), a fiscal year 1998 acquisition, against the Government also relating to a supervisory goodwill claim filed by the former Mid Continent. The Mid Continent claim was tried in June and July 2003 with a final summation completed in October 2003. A final ruling was entered on January 29, 2004, awarding the Bank $5.6 million in damages. On February 12, 2004, the Department of Justice, on behalf of the Government, filed a Defendant s Motion for Reconsideration of the ruling entered on January 29, 2004. The Government s motion argued the amount of lost profit damages awarded by the Court was inappropriate. On or about February 26, 2004 the Court denied the Government s motion. The Government has sixty days to file a formal appeal of the ruling entered on January 29, 2004. The ultimate collectibility of this award is contingent on a number of factors and future events which are beyond the control of the Bank, as to substance, timing and amount of damages that may be paid to the Bank. The Corporation has not recorded a receivable pursuant to this award.

Other Information

Additional information concerning the general business of the Corporation during the year ended December 31, 2003, is included in the following sections of this Report and under Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations and under Item 8 Notes to the Consolidated Financial Statements of this Report. Information concerning the Bank s regulatory capital requirements and other regulations, which affect the Corporation, is included in the Regulation section of this Report.

The Corporation makes its annual, current and quarterly reports available, free of charge, on its corporate web site, *www.comfedbank.com*, as reasonably practicable after such reports are electronically filed with the Securities and Exchange Commission. Other information on the Corporation and the Bank are also available on this web site. All information and reports on the Corporation s web site are not incorporated by reference to this Annual Report on Form 10-K.

Lending Activities

General

The Corporation s lending activities focus on the origination of first mortgage loans for the purpose of financing or refinancing single-family residential properties, single-family residential construction loans, commercial real estate loans, commercial operating loans, and consumer and home equity loans. The Corporation conducts loan origination activities primarily through its branch offices to leverage its extensive network. Growth in commercial real estate, commercial operating and consumer loans has been a primary focus during the year ended December 31, 2003. The origination of these loans has increased significantly over 2002. Management plans to continue to expand the Corporation s commercial lending activity in 2004 and beyond. Residential loan origination activity, including origination volume through a network of

correspondents and brokers, increased

significantly in calendar year 2003 as a direct result of the historically low interest rate environment that generated increased residential loan production volumes as well as a significant volume of loan refinancings compared to prior years. The Corporation will continue to originate real estate loans through its branches, loan offices and through its nationwide correspondent and broker network. See the Loan Activity section of this Report for further information.

The Corporation originates mortgage loans primarily secured by existing single-family residences. Single-family residential loans are originated using underwriting guidelines, appraisals and documentation which are acceptable to the Federal Home Loan Mortgage Corporation (FHLMC), the Government National Mortgage Association (GNMA) and the Federal National Mortgage Association (FNMA) to facilitate the sale of such loans to such agencies in the secondary market. The Corporation also originates single-family residential loans using internal lending policies in accordance with what management believes are prudent underwriting standards but which may not strictly adhere to FHLMC, GNMA and FNMA guidelines.

Commercial real estate loans are secured by various types of commercial properties including office buildings, shopping centers, warehouses and other income producing properties primarily located within the Corporation s primary market areas of Denver, Colorado, Omaha, Nebraska, and Des Moines, Iowa. The Corporation s single-family residential construction lending activity is primarily attributable to operations in its primary market areas and in Las Vegas, Nevada. Multi-family residential loans consist of loans secured by various types of properties, including townhomes, condominiums and apartment projects with more than four dwelling units. These properties are also primarily located in the Corporation s primary market areas.

As part of the Corporation s goal to build its commercial banking relationships, the Corporation offers an internet-based full-service cash management program. This service allows businesses access to electronic banking features such as funds transfers, vendor payments, direct payroll deposit, wire transfers and other services. Commercial operating loans are subject to prudent credit review and other underwriting standards and collection procedures. As the momentum from the strategic growth emphasis in commercial operating loans continues to build, these loans are expected to constitute a greater portion of the Corporation s lending business in the future.

In addition to real estate and commercial loans, the Corporation originates consumer, automobile, home equity, agricultural, commercial business and savings account loans, as well as consumer credit card loans, through the Corporation s branch and loan office network and direct mail solicitation. Management intends to continue to increase its consumer loan origination activity with strict adherence to prudent underwriting and credit review procedures.

Regulatory guidelines generally limit loans and extensions of credit to one borrower. At December 31, 2003, all loans were within the regulatory limitation of $202.5 million to one borrower. The aggregate amount of outstanding loans to the five highest borrowers totaled $141.6 million at December 31, 2003.

Composition of Loans Receivable Portfolio

The following table sets forth the composition of the Corporation s loans receivable portfolio as of the dates indicated below. Other than as disclosed below, there were no concentrations of loans which exceeded 10% of loans receivable at December 31, 2003.

	December 31,								June 30,	
	2003		2002		2001		2000		2000	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in Thousands)									
Loan Portfolio										
Residential real estate	$ 3,420,692	42.5%	$ 3,670,388	47.1%	$ 4,329,595	53.1%	$ 5,286,232	60.7%	$ 7,106,409	69.1%
Commercial real estate	1,969,802	24.5	1,834,512	23.5	1,711,171	21.0	1,252,744	14.4	1,107,966	10.8
Construction, net of loans-in-process	519,599	6.5	492,409	6.3	534,719	6.5	517,788	5.9	413,107	4.0
Commercial operating and other	525,431	6.5	302,906	3.9	247,823	3.0	297,904	3.4	270,699	2.6
Consumer home equity	859,383	10.7	817,912	10.5	738,784	9.1	795,821	9.1	770,832	7.5
Consumer other	750,745	9.3	675,477	8.7	592,481	7.3	564,084	6.5	617,126	6.0
Total loans receivable	8,045,652	100%	7,793,604	100%	8,154,573	100%	8,714,573	100%	10,286,139	100%
Unearned income, net	19,245		15,560		14,161		18,864		8,694	
Allowance for loan losses	(108,154)		(106,148)		(102,359)		(82,263)		(70,497)	
Total loans receivable portfolio	$ 7,956,743		$ 7,703,016		$ 8,066,375		$ 8,651,174		$ 10,224,336	

For additional information regarding the Corporation s loans receivable portfolio, see Note 4 Loans Receivable.

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The following table presents the composition of the Corporation s real estate loans receivable portfolio (before any reduction for unearned income and allowance for loan losses) by state and property type at December 31, 2003:

State	Residential Real Estate	Commercial Real Estate	Construction, Net of Loans in Process	Total	% of Total
	(Dollars in Thousands)				
Colorado	$ 462,573	$ 458,557	$ 120,039	$ 1,041,169	17.6%
Iowa	213,576	407,467	100,383	721,426	12.2
Nebraska	307,587	140,625	31,294	479,506	8.1
Kansas	265,353	148,565	32,572	446,490	7.6
Arizona	130,440	215,342	83,598	429,380	7.3
Missouri	151,414	208,443	20,469	380,326	6.4
Oklahoma	115,667	194,143	26,750	336,560	5.7
Massachusetts	322,779			322,779	5.5
Nevada	15,487	54,360	93,433	163,280	2.8
Georgia	145,910	15,346		161,256	2.7
Minnesota	152,770	1,293		154,063	2.6
Virginia	135,556			135,556	2.3
California	82,384	18,882		101,266	1.7
Texas	56,362	44,465		100,827	1.7
Washington	96,322			96,322	1.6
Maryland	94,141			94,141	1.6
Florida	57,935	15,001	11,061	83,997	1.4
Michigan	80,741			80,741	1.4
Illinois	78,546	1,968		80,514	1.4
North Carolina	53,688	4,568		58,256	1.0
Ohio	57,432			57,432	1.0
Alabama	56,442			56,442	1.0
Connecticut	45,940			45,940	0.8
South Carolina	27,816	4,593		32,409	0.5
Maine	25,571			25,571	0.4
Oregon	10,650	14,314		24,964	0.4
New Hampshire	24,120			24,120	0.4
New Jersey	19,312			19,312	0.3
Other states (22 states)	134,178	21,870		156,048	2.6
Total	$ 3,420,692	$ 1,969,802	$ 519,599	$ 5,910,093	100.0%
Percent of total	57.9%	33.3%	8.8%	100.0%	

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Contractual Principal Repayments

The following table shows the maturities of loans receivable of the Corporation s portfolio based on contractual terms. The table does not reflect the effects of loan prepayments or scheduled principal amortization. Demand loans (loans having no stated schedule of repayments and no stated maturity) and overdrafts are reported as due in one year or less. Since prepayments significantly shorten the average life of loans, management believes that the following table will bear little resemblance to what will be the actual repayments. Loan balances have not been reduced for (i) unearned income (ii) allowance for loan losses or (iii) nonperforming loans.

	Due During the Year Ended December 31,			
	2004	**2005-2008**	**After 2008**	**Total**
		(In Thousands)		
Principal Repayments				
Residential real estate:				
Fixed-rate	$ 5,412	$ 99,640	$ 1,083,402	$ 1,188,454
Adjustable-rate	4,753	26,632	2,200,853	2,232,238
	10,165	126,272	3,284,255	3,420,692
Commercial real estate:				
Fixed-rate	61,453	543,198	239,850	844,501
Adjustable-rate	89,732	166,620	868,949	1,125,301
	151,185	709,818	1,108,799	1,969,802
Construction loans, net of loans in process:				
Fixed-rate	75,504	2,305		77,809
Adjustable-rate	441,563	227		441,790
	517,067	2,532		519,599
Commercial operating and other:				
Fixed-rate	99,277	165,213	22,509	286,999
Adjustable-rate	129,710	68,132	40,590	238,432
	228,987	233,345	63,099	525,431
Consumer home equity:				
Fixed-rate	5,270	144,556	404,788	554,614
Adjustable-rate	794	3,750	300,225	304,769
	6,064	148,306	705,013	859,383
Consumer other:				
Fixed-rate	66,788	542,539	140,459	749,786
Adjustable-rate	191	181	587	959
	66,979	542,720	141,046	750,745

Total principal repayments	$ 980,447	$ 1,762,993	$ 5,302,212	$ 8,045,652

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The following table sets forth the amount of all loans receivable due after December 31, 2004 (January 1, 2005, and thereafter), which have fixed interest rates and those which have adjustable interest rates.

	Fixed-Rate	Adjustable Rate	Total
		(In Thousands)	
Residential real estate	$ 1,183,042	$ 2,227,485	$ 3,410,527
Commercial real estate	783,048	1,035,569	1,818,617
Construction loans, net of loans in process	2,305	227	2,532
Commercial operating and other	187,722	108,722	296,444
Consumer home equity	549,344	303,975	853,319
Consumer other	682,998	768	683,766
Total principal repayments due after December 31, 2004	$ 3,388,459	$ 3,676,746	$ 7,065,205

Residential Real Estate Loans

The Corporation originates and purchases both fixed-rate and adjustable-rate mortgage loans secured by single-family units through its branch network, its loan offices and a nationwide correspondent network. Such residential mortgage loans are either:

- conventional mortgage loans which comply with the requirements for sale to, or conversion into, securities issued by FNMA or FHLMC (conforming loans),
- mortgage loans which exceed the maximum loan amount allowed by FNMA or FHLMC but which otherwise generally comply with FNMA and FHLMC loan requirements, or mortgage loans not exceeding the maximum loan amount allowed by FNMA or FHLMC but do not meet all of the conformity requirements of FNMA and FHLMC (nonconforming loans) or
- Federal Housing Administration (FHA) and Department of Veteran s Administration (VA) guaranteed loans which qualify for sale in the form of securities guaranteed by GNMA.

The Corporation originates substantially all conforming or nonconforming loans with loan-to-value ratios at or below 80.0% unless the borrower obtains private mortgage insurance (which premium the borrower pays with their mortgage payment) for the Corporation s benefit covering that portion of the loan in excess of 80.0% of the appraised value or purchase price, whichever is less. Occasional exceptions to the 80.0% loan-to-value ratio for mortgage loans are made to facilitate the resolution of nonperforming assets.

Fixed-rate residential mortgage loans generally are originated with terms of 15 and 30 years and are amortized on a monthly basis with principal and interest due each month. Adjustable-rate residential mortgage loans are also originated with terms of 15 and 30 years. However, certain adjustable-rate loans contain provisions which permit the borrower, at the borrower s option, to convert to a long-term fixed-rate loan at certain periodic intervals over the life of the loan. The adjustable-rate loans generally have interest rates which are scheduled to adjust at six and 12 month intervals based upon various indices, including the Treasury Constant Maturity Index or the Eleventh District Federal Home Loan Bank Cost of Funds Index. The amount of any such interest rate increase is limited to one or two percentage points annually and four to six percentage points over the life of the loan. Certain adjustable-rate loans are also offered which have interest rates fixed over annual periods ranging from

two through seven years, or ten years, with such loans repricing annually after the fixed interest-rate term. The Corporation applies its underwriting criteria to such loans based on the amount of the loan for which the borrower could qualify at the indexed rate. At December 31, 2003, approximately 1.05%, or $35.9 million, of the Corporation s residential real estate loan portfolio was 90 days or more delinquent compared to 1.20%, or $43.9 million, at December 31, 2002.

Commercial Real Estate Loans

Commercial real estate lending entails significant additional risks compared with residential real estate lending. These additional risks are due to larger loan balances, which are more sensitive to economic conditions,

business cycle downturns and construction related risks. The payment of principal and interest due on the Corporation s commercial real estate loans is substantially dependent upon the performance of the projects securing the loans. As an example, to the extent that the occupancy and rental rates on the secured commercial real estate are not high enough to generate the income necessary to make payments, the Corporation could experience an increased rate of delinquency and could be required either to declare the loans in default and foreclose upon the properties or to make concessions on the terms of the repayment of the loans. At December 31, 2003, approximately .32%, or $6.3 million, of the Corporation s commercial real estate loans were 90 days or more delinquent compared to .83%, or $15.3 million, at December 31, 2002.

The aggregate amount of loans which a federal savings institution may make on the security of liens on nonresidential real property may not exceed 400.0% of the institution s total risk-based capital as determined under current regulatory capital standards. This limitation totaled approximately $3.4 billion at December 31, 2003, compared to $2.0 billion of actual commercial real estate loans outstanding at December 31, 2003. This restriction has not and is not expected to materially affect the Corporation s business.

Construction Loans

The Corporation conducts its construction lending operations in its primary market areas and in Las Vegas, Nevada. The residential construction lending operations are expected to continue to increase over prior periods. These loans are subject to prudent credit review and other underwriting standards and procedures. At December 31, 2003, approximately 1.01%, or $5.2 million, of the Corporation s construction loan portfolio was 90 days or more delinquent compared to 1.02%, or $5.0 million, at December 31, 2002.

Construction financing is considered to involve a higher degree of risk of loss than long-term financing on improved, occupied real estate. Risk of loss on a construction loan is dependent largely upon the accuracy of the initial estimate of the property s value at completion of construction and the total estimated cost, including interest. During the construction phase, a number of factors could result in delays and cost overruns. If the estimate of construction costs proves to be inaccurate, the Corporation may be required to advance funds beyond the amount originally committed to permit completion of the project. If the estimate of value proves to be inaccurate, the Corporation may be confronted, at or prior to the maturity of the loan, with a project having a value which is insufficient to assure full repayment.

Commercial Operating and Other Loans

Commercial operating and other loans represent commercial loans for the primary purpose of providing operating capital for commercial entities and also for agricultural and small business purposes. The performance of these loans is highly dependent on the stability of the operations of the commercial enterprise and the state of the economy as it relates to the industry of the borrower. The credit risk related to these loans is also high since the value of collateral underlying these loans may be highly specialized and more sensitive to economic downturns. At December 31, 2003, approximately .69%, or $3.7 million, of the Corporation s commercial operating loans were 90 days or more delinquent compared to 1.09%, or $3.3 million, at December 31, 2002.

Consumer Loans

Federal regulations permit federal savings institutions to make secured and unsecured consumer loans up to 35.0% of an institution s total regulatory assets. Any loans in excess of 30.0% of assets may only be made directly to the borrower and cannot involve the payment of any finders or referral fees. In addition, a federal savings institution has lending authority above the 35.0% category for certain consumer loans, such

as home equity loans, property improvement loans, mobile home loans and savings account secured loans. Consumer loans originated by the Corporation are primarily second mortgage loans, loans secured by automobiles and loans to depositors on the security of their savings accounts. The Corporation has increased its secured consumer lending activities in order to meet its customers financial needs and will continue to increase such lending activities in the future in its primary market areas. The consumer loan federal regulation limitations have not and are not expected to materially affect the Corporation s business.

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Consumer loans entail greater risk than do residential mortgage loans, particularly in the case of consumer loans, which are unsecured or secured by rapidly depreciable assets such as automobiles. In such cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. The remaining deficiency often does not warrant further substantial collection efforts against the borrower. In addition, consumer loan collections are dependent on the borrower s continuing financial stability, and thus are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount which can be recovered on such loans. Such loans may also give rise to claims and defenses by a consumer loan borrower against an assignee of such loans such as the Corporation, and a borrower may be able to assert against such assignee claims and defenses which it has against the seller of the underlying collateral. At December 31, 2003, approximately .30%, or $4.8 million, of the Corporation s consumer loans are 90 days or more delinquent compared to .32%, or $4.8 million, at December 31, 2002.

Loan Sales

In addition to originating loans for its portfolio, the Corporation participates in secondary mortgage market activities by selling whole and securitized loans to institutional investors or other financial institutions with the Corporation generally retaining the right to service such loans. Substantially all of the Corporation s secondary mortgage market activity is with GNMA, FNMA and FHLMC. Conventional conforming loans are either sold for cash as individual whole loans to FNMA or FHLMC, or pooled in exchange for securities issued by FNMA or FHLMC, which are then sold to investment banking firms. FHA and VA loans are originated or purchased by the Corporation and either are retained for the Corporation s real estate loan portfolio or are pooled to form GNMA securities which are subsequently sold to investment banking firms or retained by the Bank.

During the years ended December 31, 2003, 2002 and 2001, the Corporation sold an aggregate of $5.1 billion, $3.4 billion and $2.7 billion, respectively, in mortgage loans. These sales resulted in net realized gains during calendar years 2003, 2002 and 2001 totaling $23.9 million, $36.2 million and $8.7 million, respectively. The mortgage loans were primarily sold in the secondary market. At December 31, 2003, the carrying value of loans held for sale totaled $351.5 million compared to $914.5 million at December 31, 2002.

Loan Activity

The following table sets forth the Corporation s loan activity for the years ended December 31 as indicated:

	2003	2002	2001
		(In Thousands)	
Originations:			
Residential real estate loans	$ 2,081,142	$ 1,601,121	$ 1,201,279
Commercial real estate loans	625,277	805,639	768,578
Construction loans	734,459	792,290	728,432
Consumer and other loans	1,760,569	1,058,210	1,343,577
Loans originated	$ 5,201,447	$ 4,257,260	$ 4,041,866
Purchases:			
Residential real estate loans	$ 4,493,310	$ 3,613,275	$ 2,613,945

Commercial real estate loans			19,075
Loans purchased	$ 4,493,310	$ 3,613,275	$ 2,633,020
Securitizations:			
Mortgage loans securitized into mortgage-backed securities held by the Bank	$ 216,049	$ 76,947	$ 41,910
Sales:			
Mortgage loans sold	$ 5,107,012	$ 3,361,384	$ 2,736,379

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Loan Servicing for Other Institutions

The Corporation services substantially all of the mortgage loans that it originates and purchases (whether retained for the Bank s portfolio or sold in the secondary market), thereby generating ongoing loan servicing fee income. The Corporation also periodically purchases and sells mortgage servicing rights. During the second quarter of 2003, the Corporation sold the servicing rights relating to $501.9 million of loans serviced for other institutions. At December 31, 2003, the Corporation was servicing approximately 118,700 loans and participations for others with principal balances aggregating $11.4 billion, compared to approximately 136,200 loans and participations for others with principal balances totaling $11.5 billion at December 31, 2002.

Loan servicing includes collecting and remitting loan payments, accounting for principal and interest, holding escrow (impound funds) for payment of taxes and insurance, making inspections as required of the mortgage premises, collecting amounts due from delinquent mortgagors, supervising foreclosures in the event of unremedied defaults and generally administering the loans for the investors to whom they have been sold.

The Corporation receives fees for servicing mortgage loans for others, ranging generally from .18% to .57% per annum on the declining principal balances of the loans. The average service fee collected by the Corporation was .33%, .33% and .35%, respectively, for the years ended December 31, 2003, 2002 and 2001. The Corporation s servicing portfolio is subject to reduction primarily by reason of normal amortization and prepayment of outstanding mortgage loans. In general, the value of the Corporation s loan servicing portfolio may also be adversely affected as mortgage interest rates decline and loan prepayments increase. It is expected that income generated from the Corporation s loan servicing portfolio also will decline in such an environment. This negative effect on the Corporation s income may be offset somewhat by a rise in origination and servicing fee income attributable to new loan originations, which historically have increased in periods of low mortgage interest rates. The weighted average mortgage loan note rate of the Corporation s servicing portfolio at December 31, 2003, was 6.09% compared to 6.82% at December 31, 2002.

At December 31, 2003 and 2002, approximately 95.7% and 95.3%, respectively, of the Corporation s mortgage servicing portfolio for other institutions was covered by servicing agreements pursuant to the mortgage-backed securities programs of GNMA, FNMA and FHLMC. Under these agreements, the Corporation may be required to advance funds temporarily to make scheduled payments of principal, interest, taxes or insurance if the borrower fails to make such payments. Although the Corporation cannot charge any interest on these advanced funds, the Corporation typically recovers the advances within a reasonable number of days upon receipt of the borrower s payment, or in the absence of such payment, advances are recovered through FHA insurance, VA guarantees or FNMA or FHLMC reimbursement provisions in connection with loan foreclosures. During each of the years ended December 31, 2003 and 2002, the average amount of funds advanced by the Corporation pursuant to servicing agreements totaled approximately $4.3 million.

Interest Rates and Loan Fees

Interest rates charged by the Corporation on its loans are primarily determined by secondary market yield requirements and competitive loan rates offered in its lending areas. In addition to interest earned on loans, the Corporation receives loan origination fees for originating certain loans. These fees are a percentage of the principal amount of the mortgage loan and are charged to the borrower.

Loan Commitments

At December 31, 2003, the Corporation had issued commitments totaling $931.9 million, excluding the undisbursed portion of loans in process, to fund and purchase loans and to extend credit on consumer and commercial unused lines of credit. These commitments are generally expected to settle within three months following December 31, 2003. These outstanding loan commitments to extend credit do not necessarily represent future cash requirements since many of the commitments may expire without being drawn. Additionally,

mortgage loan commitments included in total commitments include loans in the process of approval for which the Corporation has rate lock commitments. The Corporation expects to have sufficient liquidity to fund these loan commitments. See MD&A Liquidity and Capital Resources and Contractual Obligations and Other Commitments of this Report.

Collection Procedures

If a borrower fails to make required payments on a loan, the Corporation generally will take immediate action to satisfy its claim against the security on the loan. If a delinquency cannot otherwise be cured, the Corporation records a notice of default and commences foreclosure proceedings. When a trustee sale is held, the Corporation generally acquires title to the property. The property may then be sold for cash or with financing conforming to normal loan requirements, or it may be sold or financed with a loan to facilitate involving terms more favorable to the borrower than those permitted by applicable regulations for new loans.

Asset Quality

Nonperforming Assets

Loans are reviewed on a regular basis and, except for first mortgage loans and credit card loans, are placed on a nonaccruing status when either principal or interest is 90 days or more past due. Interest accrued and unpaid at the time a loan is placed on nonaccruing status is charged against interest income. First mortgage loans are placed on a nonaccruing status if four or more monthly payments are missed. Credit card loans continue to accrue interest up to 120 days past due at which time the credit card loan balance plus accrued interest are charged off.

Real estate acquired by the Corporation as a result of foreclosure or by deed in lieu of foreclosure is classified as foreclosed real estate. At foreclosure, such property is stated at the lower of cost or fair value, minus estimated costs to sell. Subsequent impairment losses are recorded when the carrying value exceeds the fair value minus estimated costs to sell the property.

In certain circumstances the Corporation does not immediately foreclose when a delinquency is not cured promptly, particularly when the borrower does not intend to abandon the collateral, since by not foreclosing the risk of ownership would still be retained by the borrower. The evaluation of borrowers and collateral may involve determining that the most economic way to reduce the Corporation s risk of loss may be to allow the borrower to remain in possession of the property and to restructure the debt as a troubled debt restructuring. In these circumstances, the Corporation would strive to ensure that the borrower s continued participation in and management of the collateral does not put the Corporation at further risk of loss. In situations in which the borrower is not performing under the restructured terms, foreclosure proceedings are commenced when legally allowable.

A troubled debt restructuring is a loan in which the Corporation, for reasons related to the debtor s financial difficulties, grants a concession to the debtor, such as a reduction in the loan s interest rate, a reduction in the face amount of the debt, or an extension of the maturity date of the loan, that the Corporation would not otherwise consider. A loan classified as a troubled debt restructuring may be reclassified as current if such loan has returned to a performing status at a market rate of interest for at least eight to twelve months, the loan-to-value ratio is 80.0% or less, the cash flows generated from the collateralized property support the loan amount subject to minimum debt service coverage, as defined, and overall applicable economic conditions are favorable.

For a discussion of the major components of the changes in nonperforming assets at December 31, 2003, compared to December 31, 2002, see MD&A Provision for Loan Losses and Asset Quality of this Report.

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The following table sets forth information with respect to the Corporation s nonperforming assets as follows:

	December 31,				June 30,
	2003	2002	2001	2000	2000
	(Dollars in Thousands)				
Loans accounted for on a nonaccrual basis: (1)					
Real estate					
Residential	$ 40,065	$ 46,394	$ 52,792	$ 46,075	$ 37,535
Commercial	7,363	17,890	23,423	27,349	2,550
Consumer, commercial operating and other loans	8,491	8,130	6,929	10,019	13,466
Total nonperforming loans	55,919	72,414	83,144	83,443	53,551
Foreclosed real estate:					
Commercial	32,839	24,707	30,368	10,198	12,862
Residential	16,905	15,301	14,840	15,824	16,803
Total foreclosed real estate	49,744	40,008	45,208	26,022	29,665
Troubled debt restructurings: (2)					
Commercial	4,712	1,547	3,057	4,195	5,259
Residential			84	90	172
Total troubled debt restructurings	4,712	1,547	3,141	4,285	5,431
Total nonperforming assets	$ 110,375	$ 113,969	$ 131,493	$ 113,750	$ 88,647
Nonperforming loans to loans receivable (3)	.69%	.93%	1.02%	.96%	.52%
Nonperforming assets to total assets	.91%	.87%	1.02%	.91%	.64%
Allowance for loan losses	$ 108,154	$ 106,291	$ 102,451	$ 83,439	$ 70,556
Allowance for loan losses to:					
Loans receivable (3)	1.34%	1.36%	1.25%	.96%	.69%
Total nonperforming loans	193.41%	146.78%	123.22%	100.00%	131.75%

(1) Excluding credit card loans, no interest income was recorded on loans contractually past due 90 days or more during the years ended December 31, 2003, 2002 and 2001, the six months ended December 31, 2000, or during the fiscal year ended June 30, 2000. Had these nonaccruing loans, excluding credit card loans, been current in accordance with their original terms and outstanding throughout this year or since origination, the Corporation would have recorded gross interest income on these loans totaling $3.4 million, $6.5 million, $6.4 million, $5.3 million and $3.8 million, respectively, during the aforementioned periods. Residential real estate loans are considered nonperforming if four or more monthly payments are missed. Credit card loans continue to accrue interest up to 120 days past due at which point the credit card loan balances plus accrued interest are charged off.

(2) During the years ended December 31, 2003, 2002 and 2001, the six months ended December 31, 2000, and the fiscal year ended June 30, 2000, the Corporation recognized interest income on loans classified as troubled debt restructurings aggregating $238,000, $224,000, $236,000, $176,000 and $430,000, respectively, whereas under their original terms the Corporation would have recognized interest income of $254,000, $255,000, $268,000, $194,000 and $494,000, respectively. At December 31, 2003, the Corporation had no commitments to lend additional funds to borrowers whose loans were subject to troubled debt restructuring.

(3) Based on the net book value of loans receivable before deducting allowance for loan losses at the respective dates.

The preceding table excludes nonperforming loans held for sale totaling $25.0 million, $32.0 million and $37.9 million, respectively, at December 31, 2003, 2002 and 2001, related to the GNMA optional repurchase program. These guaranteed mortgage loans serviced for GNMA include loans that have been repurchased or are

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eligible for repurchase by the Corporation at the Corporation s option and without prior authorization from GNMA when specific delinquency criteria are met. Therefore, the Corporation is deemed to have regained effective control over these loans. These nonperforming loans are guaranteed by the FHA or VA with the Corporation either reselling these loans or undertaking collection efforts through the FHA/VA foreclosure process for reimbursement of these repurchased loans. The Corporation is reimbursed for substantially all costs incurred after the foreclosure process is complete. There were no nonperforming loans held for sale at December 31, 2000, and June 30, 2000.

The geographic concentration of nonperforming loans in the Corporation s primary market areas and those states with 10% or more of total nonperforming loans at December 31, 2003, follows:

State	Amount	Percent
	(Dollars in Thousands)	
Iowa	$ 8,282	14.8%
Oklahoma	7,413	13.3
Colorado	6,971	12.5
Kansas	6,846	12.2
Nebraska	3,426	6.1
Missouri	1,998	3.6
Arizona	1,293	2.3
Other states (32 states)	19,690	35.2
Nonperforming loans	$ 55,919	100.0%

Nonperforming loans at December 31 consisted of the following types and number of loans:

	2003		2002	
	Amount	Number of Loans	Amount	Number of Loans
	(Dollars in Thousands)			
Residential real estate loans	$ 35,907	550	$ 43,939	750
Commercial real estate loans	6,286	24	15,306	40
Residential construction loans	4,158	11	2,243	10
Commercial construction loans	1,077	3	2,796	3
Consumer loans	4,840	365	4,820	467
Agricultural loans	1,301	8	1,865	23
Commercial operating loans	1,968	24	1,334	28
Small business loans	382	5	111	3
Totals	$ 55,919	990	$ 72,414	1,324

The geographic concentration of foreclosed real estate in the Corporation s primary market areas and those states with 10% or more of total foreclosed real estate at December 31, 2003, follows:

State	Amount	Percent
	(Dollars in Thousands)	
Nevada	$ 28,361	57.0%
Colorado	4,833	9.7
Iowa	4,149	8.3
Oklahoma	2,936	5.9
Kansas	1,860	3.7
Nebraska	1,471	3.0
Missouri	908	1.8
Arizona	798	1.6
Other states (22 states)	4,428	9.0
Foreclosed real estate	$ 49,744	100.0%

At December 31, 2003, foreclosed real estate totaling $49.7 million (341 properties) consisted of commercial real estate totaling $32.8 million (15 properties) or 66.0% of the total and residential real estate totaling $16.9 million (326 properties). The real estate located in Nevada primarily consists of a residential master planned community property totaling $28.4 million at December 31, 2003. The Corporation continues to develop and manage this property while listing such property for sale.

Under the Corporation s credit policies and practices, certain real estate loans meet the definition of impaired loans under Statement of Financial Accounting Standards No. 114, Accounting by Creditors for Impairment of a Loan and Statement of Financial Accounting Standards No. 118, Accounting by Creditors for Impairment of a Loan Income Recognition and Disclosures. A loan is considered impaired when it is probable that the Corporation, based upon current information, will not collect amounts due, both principal and interest, according to the contractual terms of the loan agreement. Loan impairment is measured based on the present value of expected future cash flows discounted at the loan s effective interest rate or, as a practical expedient, at the observable market price of the loan or the fair value of the collateral if the loan is collateral dependent. Certain loans are exempt from the provisions of the aforementioned accounting statements, including large groups of smaller-balance homogenous loans that are collectively evaluated for impairment which, for the Corporation, include one-to-four family first mortgage loans and consumer loans.

Loans reviewed for impairment by the Corporation are primarily commercial loans and loans modified in a troubled debt restructuring. The Corporation s impaired loan identification and measurement processes are conducted in conjunction with the Corporation s review of classified assets and the adequacy of its allowance for possible loan losses. Specific factors utilized in the impaired loan identification process include, but are not limited to, delinquency status, loan-to-value ratio, debt coverage and certain other conditions pursuant to the Corporation s classification policy. At December 31, 2003, the Corporation had impaired loans totaling $28.5 million, net of specific allowances. Troubled debt restructurings totaling $4.2 million, net of specific allowances, are classified as impaired loans and included in the table for nonperforming assets. At December 31, 2002, impaired loans totaled approximately $13.3 million.

Classification of Assets

Savings institutions are required to review their assets on a regular basis and, as warranted, classify them as substandard, doubtful, or loss as defined by OTS regulations. Adequate valuation allowances are required to be established for assets classified as substandard or doubtful. If an asset is classified as a loss, the institution must either establish a specific valuation allowance equal to the amount classified as loss or charge off such amount. An asset which does not currently warrant classification as substandard but which possesses credit deficiencies or potential weaknesses deserving close attention is required to be designated as special mention. In addition, a savings institution is required to set aside adequate valuation allowances to the extent that any affiliate possesses assets which pose a risk to the savings institution. The OTS has the authority to approve, disapprove or modify any asset classification or any amount established as an allowance pursuant to such classification. The Corporation generally charges off the amount of loans classified as loss. At December 31, 2003, the Corporation had $37.8 million in assets classified as special mention, $198.7 million in assets classified as substandard, $4.2 million in assets classified as doubtful and no assets classified as loss. Substantially all nonperforming assets at December 31, 2003, are classified as substandard pursuant to applicable asset classification standards. Of the Corporation s loans which were not classified at December 31, 2003, there were no loans where known information about possible credit problems of borrowers caused management to have serious doubts as to the ability of the borrowers to comply with present loan repayment terms.

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Loan and Real Estate Review Policy

Management of the Corporation has the responsibility for establishing policies and procedures for the timely evaluation of the credit risk in the Corporation s loan and real estate portfolios. Management is also responsible for the determination of all specific and estimated provisions for loan losses and impairments for real estate losses, taking into consideration a number of factors, including changes in the composition of the Corporation s loan portfolio and real estate balances, current economic conditions, including real estate market conditions in the Corporation s lending areas that may affect the borrower s ability to make payments on loans, regular examinations by the Corporation s credit review team of the quality of the overall loan and real estate portfolios, and regular review of specific problem loans and real estate.

Management also has the responsibility of ensuring timely charge-offs of loan and real estate balances, as appropriate, when general and economic conditions warrant a change in the value of these loans and real estate. To ensure that credit risk is properly and timely monitored, this responsibility has been delegated to a credit review team which consists of key personnel of the Corporation knowledgeable in the specific areas of loan and real estate valuation.

The objectives of the credit review team are:

- to examine the risk of collectibility of the Corporation s loans,
- to assess the likelihood of partial or full liquidation of real estate and other assets,
- to confirm problem assets at the earliest possible time,
- to assure an adequate level of allowances for loan losses to cover identified and anticipated credit risks,
- to monitor the Corporation s compliance with established policies and procedures, and
- to provide the Corporation s management with information obtained through the asset review process.

The Corporation s policy for calculating the allowance for loan losses on the commercial loan portfolio (commercial real estate, construction, commercial operating and agricultural) incorporates classifying the credit risk of the portfolio into eight categories. Classes one through four (excellent, good, satisfactory and acceptable, respectively) represent varying degrees of pass rated credits, or minimal credit risk. Classes five (special mention), six (substandard), seven (doubtful) and eight (loss), mirror regulatory definitions and are consistent between all commercial loan types. These credit risk categories are designed to more accurately reflect the inherent risk in the Corporation s loan portfolio relative to the current economic environment. The credit review team analyzes all significant loans and real estate of the Corporation for appropriate levels of allowance for loan losses and real estate impairment losses based on varying degrees of loan or real estate value weakness.

Loans with minimal credit risk (not adversely classified or with a credit risk rating of one to five) generally have allowances established on the basis of the Corporation s historical loss experience and various other factors. Loans adversely classified (substandard, doubtful, loss or with a credit risk rating of six to eight) have greater levels of allowances established, including specific allowances, if applicable, to recognize

impairment in the value of loans. Impairment losses are recorded on real estate when the fair value less estimated selling costs of the property is less than the carrying value of the property.

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It is management s responsibility to maintain a reasonable allowance for loan losses applicable to all categories of loans through periodic charges to operations. Management employs a systematic methodology to determine the amount of specific allowances allocated to specific loans. Specific loans that are impaired, or any portion impaired, may be allocated a specific allowance equal to the amount of impairment or, instead of establishing a specific allowance, the impaired portion also may be 100% charged off when management determines such amount to be uncollectible. The estimated allowances established on each of the Corporation s specific pools of outstanding loan portfolios is based on a minimum and maximum percentage range of the specific portfolios as follows:

Type of Loan and Status	Minimum Loan Loss Percentage	Maximum Loan Loss Percentage
Residential real estate loans:		
Current	.10%	.20%
90 days delinquent (or classified substandard)	7.50	10.00
Commercial real estate loans: (1)		
Class 1 excellent	.25	.50
Class 2 good	.60	1.20
Class 3 satisfactory	.85	1.70
Class 4 acceptable	1.35	2.70
Construction loans: (1)		
Class 1 excellent	.45	.90
Class 2 good	.80	1.60
Class 3 satisfactory	1.05	2.10
Class 4 acceptable	1.55	3.10
Commercial operating loans: (1)		
Class 1 excellent	.55	1.10
Class 2 good	.90	1.80
Class 3 satisfactory	1.15	2.30
Class 4 acceptable	1.65	3.30
Agricultural loans: (1)		
Class 1 excellent	.30	.60
Class 2 good	.65	1.30
Class 3 satisfactory	.90	1.80
Class 4 acceptable	1.40	2.80
Consumer loans:		
Current auto	1.75	2.50
Current indirect	2.75	3.50
Current home equity	.75	1.50
Current all other	2.75	3.50
Substandard and 90 days delinquent	20.00	30.00
120 days delinquent (unsecured balances of consumer loans 120 days delinquent are generally written off)	100.00	100.00
Small business loans:		
Pass	2.00	4.00
Special mention	2.00	10.00
Substandard	30.00	50.00
Doubtful/loss	100.00	100.00
Credit card/taxsaver:		
Current standard	4.50	5.50
Current taxsaver	2.00	3.00
Substandard and 90 days delinquent	20.00	30.00
120 days delinquent (credit cards 120 days delinquent are generally written off)	100.00	100.00
Commercial leases:		

Pass	2.00	4.00
Special mention	2.00	10.00
Substandard	30.00	50.00
Doubtful/loss	100.00	100.00

(1) Loans rated class five through class eight have the following minimum and maximum allowance requirement ranges: class five (special mention) 5.00% to 10.00%, class six (substandard) 10.00% to 20.00%, class seven (substandard) 50.00% to 75.00% and class eight (doubtful) 100.00% and 100.00%.

The allowance for loan losses is based upon management s continuous evaluation of the collectibility of outstanding loans which takes into consideration such factors as changes in the composition of the loan portfolio and economic and business conditions that may affect the borrower s ability to pay, credit quality and delinquency trends, regular examinations by the Corporation s credit review team of specific problem loans and of the overall portfolio quality and real estate market conditions in the Corporation s lending areas.

Management determines the elements of the allowance through two methods. The first valuation process is the analysis of specific loans for individual impairment. This impairment is measured according to the provisions of Statements of Financial Accounting Standards No. 114, Accounting by Creditors for Impairment of a Loan and No. 118, Accounting by Creditors for Impairment of a Loan Income Recognition and Disclosures. Management applies specific monitoring policies and procedures that vary according to the relative risk profile and other characteristics of the loans within the various loan portfolios. Management completes periodic specific credit evaluations on commercial real estate, construction, commercial operating, and agricultural loans and loan relationships with committed balances in excess of $1.0 million. Management reviews these loans to assess the ability of the borrower to service all principal and interest obligations and, as a result, may adjust the risk grade accordingly. Loans and loan relationships in these portfolios which possess, in management s estimation, potential or well defined weaknesses which could affect the full collection of the Corporation s contractual principal and interest are evaluated under more stringent reporting and oversight procedures. These specific loans are classified as either special mention, substandard, doubtful or loss. The loans, or a portion of a loan, classified as loss are allocated a specific allowance equal to 100% of the amount of the loan, or such loan is charged off.

The second valuation process in determining the estimated allowance is based on minimum and maximum range percentages applied to each of the Corporation s pools of outstanding loan portfolios. The Corporation s residential, small business, consumer and credit card portfolios are relatively homogenous. Generally, no single loan is individually significant in terms of its size or potential loss. Therefore, management reviews these portfolios by analyzing their performance as a specific pool against which management estimates an allowance for impairment. Management s determination of the level of the allowance within the minimum and maximum percentages for these homogenous pools rests upon various judgments and assumptions used to determine the impairment related to the risk characteristics of the specific portfolio pools. The minimum and maximum range percentages are evaluated at least on a quarterly basis for appropriateness based on historical write-offs, delinquency trends, economic conditions and other factors.

The Corporation s policy is to charge-off loans or portions thereof against the allowance for loan losses in the period in which loans or portions thereof are determined to be uncollectible. Management of the Corporation anticipates that 2004 loan charge-offs will approximate 2003 historical experience. When the Corporation records charge-offs on these loans, it typically also begins the foreclosure process of taking possession of the real estate which served as collateral for such loans. A majority of the Corporation s loans are collateralized by residential or commercial real estate. Therefore, the collectibility of such loans is susceptible to changes in prevailing real estate market conditions and other factors which can cause the fair value of the collateral to decline below the loan balance. Recoveries of loan charge-offs occur when the loan payments are received on the deficient loan in excess of the remaining recorded book balance of the loan. Upon foreclosure and conversion of the loan into real estate owned, the Corporation may realize income through the disposition of such real estate when the sale proceeds exceed the carrying value of the real estate.

Although management believes that the Corporation s allowance for loan losses is adequate to reflect the risk inherent in its portfolios, there can be no assurance that the Corporation will not experience increases in its nonperforming assets, that it will not increase the level of its allowances in the future or that significant provisions for losses will not be required based on factors such as deterioration in market conditions, changes in borrowers financial conditions, delinquencies and defaults. In addition, regulatory agencies review the adequacy of the allowance for loan losses on a regular basis as an integral part of their examination process. Such agencies may require additions to the allowance based on their judgments of information available to them at the time of their examinations.

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The following table sets forth the activity in the Corporation s allowance for loan losses for the periods indicated:

	Year Ended December 31,			Six Months Ended December 31,	Year Ended June 30,
	2003	2002	2001	2000	2000
	(Dollars in Thousands)				
Allowance for loan losses at beginning of year	$ 106,291	$ 102,451	$ 83,439	$ 70,556	$ 80,419
Loans charged-off:					
Single-family residential	(2,834)	(4,743)	(2,405)	(909)	(1,874)
Multi-family residential and commercial real estate	(2,400)	(8,247)	(1,054)	(2,564)	(1,938)
Consumer and other	(21,094)	(19,703)	(21,615)	(13,435)	(20,350)
Loans charged-off	(26,328)	(32,693)	(25,074)	(16,908)	(24,162)
Recoveries:					
Single-family residential	1		6	9	81
Multi-family residential and commercial real estate	429	60			5
Consumer and other	6,376	5,615	5,312	2,539	5,747
Recoveries	6,806	5,675	5,318	2,548	5,833
Net loans charged-off	(19,522)	(27,018)	(19,756)	(14,360)	(18,329)
Provision charged to operations	22,003	31,002	38,945	27,854	13,760
Change in estimate of allowance for bulk purchased loans	(779)	(144)	(172)	(87)	(5,294)
Charge-off to allowance on sale of securitized loans			(5)	(496)	
Charge-off to allowance for bulk purchased loans				(28)	
Other	161				
Allowance for loan losses at end of year	$ 108,154	$ 106,291	$ 102,451	$ 83,439	$ 70,556
Ratio of net loans charged-off to average loans receivable outstanding during the period	.25%	.34%	.23%	.14%	.19%
Average balance of outstanding loans receivable	$ 7,851,848	$ 7,951,229	$ 8,440,881	$ 10,049,346	$ 9,710,022

Investment Activities

Management believes that the Bank s procedures for managing liquidity are sufficient to ensure its safe and sound operation. The Corporation s management objective is to maintain liquidity at a level sufficient to assure adequate and readily available funds by investing primarily in short-term liquid assets, taking into account anticipated cash flows and available sources of credit. The Bank s procedures for managing its liquidity also allow for future flexibility to meet withdrawal requests, to fund loan commitments, to maximize income while protecting against credit risks and to balance the repricing characteristics of the Corporation s assets and liabilities. Such liquid funds are managed in an effort to produce the highest yield consistent with maintaining safety of principal. The relative size and mix of investment securities in the Corporation s portfolio are based on management s judgment compared to the yields and maturities available on other investment securities. The Corporation emphasizes low credit risk in selecting investment options. Federal regulations outline the permissible investments for federal savings associations. Subject to certain restrictions and limitations, these permissible investments are generally of relatively low credit risk. The Bank invests only in permissible investments consistent with all applicable regulations.

The following table sets forth the carrying value of the Corporation s available-for-sale investment securities and short-term cash investments as of December 31 as follows:

	2003	2002
	(In Thousands)	
U.S. Treasury and other Government agency obligations	$ 669,490	$ 882,017
Obligations of states and political subdivisions	235,276	228,648
Other debt securities	150,289	185,385
Total investment securities	1,055,055	1,296,050
Short-term cash investments	1,334	505
Total investments	$ 1,056,389	$ 1,296,555

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The following table sets forth the scheduled maturities, amortized cost, market values and weighted average yields for the Corporation s investment securities at December 31, 2003:

	One Year or Less		Over One Within Five Years		Over Five Within Ten Years		More Than Ten Years		Total		
	Amortized Cost	Average Yield	Amortized Cost	Average Yield	Amortized Cost	Average Yield	Amortized Cost	Average Yield	Amortized Cost	Average Yield	Market Value
	(Dollars in Thousands)										
U.S. Treasury and other Government agency obligations	$	%	$ 176	5.58%	$ 675,136	4.59%	$	%	$ 675,312	4.59%	$ 669,490
States and political subdivisions	568	5.34	22,093	5.76	7,357	4.65	188,663	4.73	218,681	4.84	235,276
Other debt securities	150	2.29	3,989	4.81	7,699	7.40	138,198	2.87	150,036	3.24	150,289
Total	$ 718	4.70%	$ 26,258	5.62%	$ 690,192	4.62%	$ 326,861	3.98%	$ 1,044,029	4.43%	$ 1,055,055

For further information regarding the Corporation s investment securities available for sale, see Note 2 Investment Securities.

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Sources of Funds

General

Deposits are the primary source of the Corporation s funding for lending and other investment purposes. In addition to deposits, the Corporation derives funds from principal and interest repayments on loans and mortgage-backed securities, sales of loans, FHLB advance borrowings, prepayment and maturity of investment securities, and other borrowings. At December 31, 2003, deposits made up 57.9% of total deposits and interest-bearing liabilities compared to 54.1% at December 31, 2002. Deposit levels are significantly influenced by general interest rates, economic conditions and competition. Other borrowings, primarily FHLB advances, are utilized to compensate for any decreases in the normal or expected inflow of deposits.

Deposits

The Corporation s deposit strategy is to emphasize acquisition and retention of consumer and commercial deposits obtained primarily through the retail branch network from retail, commercial and small business customers. Deposits are obtained through extensive marketing and advertising efforts and product promotion, such as offering a variety of checking accounts and other deposit programs to satisfy customer needs. The Corporation has increased its non-interest-bearing checking accounts and plans a continued focus on the growth of non-interest-bearing checking accounts in the future. In addition, the Corporation intends to continue pricing its deposit products at rates that minimize the Corporation s total costs of funds while still allowing the Corporation to retain the customer deposit and the overall customer relationship. Rates on deposits are set based on the competitive environment, what is considered necessary in order to retain the customer deposit and relationship, and also considering other investment opportunities available to the customers. In addition, rates on deposits are based upon the Corporation s desire to control the flow of funds in its deposit accounts according to its business objectives and the cost of alternative sources of funds.

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The following table sets forth the balances and percentages of the various types of deposits offered by the Corporation at the date indicated and the change in the dollar amount of deposits between such dates:

	December 31, 2003			December 31, 2002			December 31, 2001	
	Amount	% of Deposits	Increase (Decrease)	Amount	% of Deposits	Increase (Decrease)	Amount	% of Deposits
	(Dollars in Thousands)							
Checking accounts								
Interest-bearing	$ 546,110	8.5%	$ 51,263	$ 494,847	7.7%	$ (3,875)	$ 498,722	7.8%
Non-interest-bearing	638,658	9.9	118,094	520,564	8.1	116,715	403,849	6.3
Custodial escrow	299,249	4.6	(154,670)	453,919	7.0	157,844	296,075	4.6
Total checking accounts	1,484,017	23.0	14,687	1,469,330	22.8	270,684	1,198,646	18.7
Savings accounts	1,267,916	19.6	(350,677)	1,618,593	25.1	(321,003)	1,939,596	30.3
Money market accounts	1,099,478	17.1	593,799	505,679	7.9	201,059	304,620	4.8
Certificates of deposit	2,603,199	40.3	(242,240)	2,845,439	44.2	(108,221)	2,953,660	46.2
Total deposits	$ 6,454,610	100.0%	$ 15,569	$ 6,439,041	100.0%	$ 42,519	$ 6,396,522	100.0%

The following table shows the composition of average deposit balances and average rates for the years ended December 31:

	2003		2002		2001	
	Average Balance	Avg. Rate	Average Balance	Avg. Rate	Average Balance	Avg. Rate
	(Dollars in Thousands)					
Non-interest-bearing checking accounts	$ 1,059,562	%	$ 728,774	%	$ 599,205	%
Interest-bearing checking accounts	540,489	.47	549,767	.25	520,014	.80
Savings accounts (1)	1,416,203	4.25	1,802,558	4.32	1,958,022	4.73
Money market acounts	893,820	1.58	314,243	1.32	335,798	2.77
Certificates of deposit	2,719,225	2.58	2,862,960	3.36	3,709,030	5.51
Average deposit accounts	$ 6,629,299	2.22%	$ 6,258,302	2.87%	$ 7,122,069	4.36%

(1) The average rate is affected by interest expense on interest rate swap agreements totaling $48.6 million, $50.4 million and $28.1 million for the respective periods.

The following table sets forth the Corporation s certificates of deposit (fixed maturities) classified by rates at December 31:

Rate	2003	2002	2001
		(In Thousands)	
Less than 2.00%			