CALIFORNIA FEDERAL PREFERRED CAPITAL CORPATION
Form 10-Q
August 09, 2001

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: June 30, 2001 Commission file number: 1-12639

CALIFORNIA FEDERAL PREFERRED CAPITAL CORPORATION
(Exact name of registrant as specified in its charter)

Maryland	94-3254883
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
200 Crescent Court, Suite 1350, Dallas, Texas	75201
(Address of principal executive offices)	(Zip Code)

214-871-5131
(Registrant's telephone number, including area code)

N/A
(Former name, former address and former fiscal year, if changed since last report)

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. [X] Yes [ ] No

The number of shares outstanding of registrant's $0.01 par value common stock, as of the close of business on August 3, 2001: 1,000 shares.

CALIFORNIA FEDERAL PREFERRED CAPITAL CORPORATION
SECOND QUARTER 2001 REPORT ON FORM 10-Q
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CALIFORNIA FEDERAL PREFERRED CAPITAL CORPORATION

BALANCE SHEETS
June 30, 2001 and December 31, 2000
(Unaudited)

(dollars in thousands, except per share data)

	June 30, 2001
ASSETS	
Residential mortgage loans, net	$ 948,393
Cash and cash equivalents	19,059
Due from affiliates	39,776
Accrued interest receivable	5,077
Foreclosed real estate, net	38
TOTAL ASSETS	$ 1,012,343
LIABILITIES AND STOCKHOLDERS' EQUITY	
Due to affiliates	$ 410
Accounts payable and accrued liabilities	272
Total Liabilities	682
Commitments and contingencies	--
Stockholders' Equity:	
Preferred stock, par value $0.01 per share, liquidation preference $500,000, 30,000,000 shares authorized, 20,000,000 shares issued and outstanding	500,000
Common stock, par value $0.01 per share, 30,000,000 shares authorized, 1,000 shares issued and outstanding	--
Additional paid-in capital	500,000
Retained earnings (accumulated deficit)	11,661
Total Stockholders' Equity	1,011,661
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 1,012,343

See accompanying notes to unaudited financial statements.

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CALIFORNIA FEDERAL PREFERRED CAPITAL CORPORATION

STATEMENTS OF INCOME
Six Months Ended June 30, 2001 and 2000
(Unaudited)
(in thousands)

	2001	2000
INTEREST INCOME		
Residential mortgage loans	$36,052	$35,577
Less: servicing fee expense	(1,839)	(1,817)
	34,213	33,760
Short-term investments	446	447
Interest income, net of servicing fee expense	34,659	34,207
NONINTEREST EXPENSE		
Director fees	14	10
Professional fees	38	42
Foreclosed real estate operations, net	(47)	(119)
Other	32	81
Total noninterest expense	37	14
NET INCOME	34,622	34,193
Preferred stock dividends	22,812	22,812
NET INCOME AVAILABLE TO COMMON STOCKHOLDER	$11,810	$11,381

See accompanying notes to unaudited financial statements.

CALIFORNIA FEDERAL PREFERRED CAPITAL CORPORATION

STATEMENTS OF INCOME
Three Months Ended June 30, 2001 and 2000
(Unaudited)
(in thousands)

	2001	2000
INTEREST INCOME		
Residential mortgage loans	$17,570	$17,932
Less: servicing fee expense	(910)	(913)

	16,660	17,019
Short-term investments	241	275
Interest income, net of servicing fee expense	16,901	17,294
NONINTEREST EXPENSE		
Director fees	6	4
Professional fees	30	13
Foreclosed real estate operations, net	(33)	(52)
Other	8	9
Total noninterest expense	11	(26)
NET INCOME	16,890	17,320
Preferred stock dividends	11,406	11,406
NET INCOME AVAILABLE TO COMMON STOCKHOLDER	$ 5,484	$ 5,914

See accompanying notes to unaudited financial statements.

CALIFORNIA FEDERAL PREFERRED CAPITAL CORPORATION

STATEMENT OF STOCKHOLDERS' EQUITY
Six Months Ended June 30, 2001
(Unaudited)
(dollars in thousands)

	Preferred Stock	Common Stock	Additional Paid-in Capital	Retaine Earning (Accumula Deficit
BALANCE AT DECEMBER 31, 2000	$500,000	$ --	$500,000	$ (14
Net income	--	--	--	34,6
Dividends paid on 9 1/8% noncumulative exchangeable preferred stock, series A	--	--	--	(22,81
BALANCE AT JUNE 30, 2001	$500,000	$ --	$500,000	$ 11,6

See accompanying notes to unaudited financial statements.

CALIFORNIA FEDERAL PREFERRED CAPITAL CORPORATION

STATEMENTS OF CASH FLOWS
Six Months Ended June 30, 2001 and 2000
(Unaudited)
(in thousands)

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OPERATING ACTIVITIES:	
Net income	$ 34
Adjustments to reconcile net income to net cash provided by operating activities:	
Amortization of purchase discounts and premiums, net	1
Interest capitalized on negatively amortizing loans	
Gain on sales of foreclosed real estate, net	
(Increase)/decrease in due from affiliates	
Decrease/(increase) in accrued interest receivable	1
(Decrease)/increase in accounts payable and accrued liabilities	
Increase in due to affiliates	
Net cash provided by operating activities	36
INVESTING ACTIVITIES:	
Purchase of mortgage loans	(154
Mortgage loan principal repayments	151
Purchase of accrued interest receivable	
Proceeds from sales of foreclosed real estate	
Net cash used in investing activities	(3
FINANCING ACTIVITIES:	
Preferred stock dividends paid	(22
Net cash used in financing activities	(22
NET INCREASE IN CASH AND CASH EQUIVALENTS	10
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	8
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 19

Supplemental disclosure of cash flow information:

Non-cash investing activities:	
Mortgage loan principal (decrease) increase for timing difference between principal repayments received by servicer and related cash received by Company during the period	$(24,

See accompanying notes to unaudited financial statements.

CALIFORNIA FEDERAL PREFERRED CAPITAL CORPORATION
NOTES TO UNAUDITED FINANCIAL STATEMENTS

(1) Basis of Presentation

The accompanying financial statements of California Federal Preferred Capital Corporation (the "Company") were prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions for meeting the requirements of Regulation S-X, Article 10 and therefore do not include all disclosures necessary for complete financial statements. In the opinion of management, all adjustments have been made that are necessary for a fair presentation of the financial position and results of operations and cash flows as of and for the periods presented. All such adjustments are of a normal recurring nature. The results of operations for the six months ended June 30, 2001 are not necessarily indicative of the results that may be expected for the entire fiscal year or any other interim period. Certain amounts from prior periods have been reclassified to conform with the current period's presentation.

The accompanying financial statements should be read in conjunction with the financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2000. All terms used but not defined elsewhere herein have meanings ascribed to them in the Company's Annual Report on Form 10-K.

As the Company's common stock is wholly owned by California Federal Bank (the "Bank"), earnings per share data is not presented.

(2) Residential Mortgage Loans, Net

At June 30, 2001 and December 31, 2000, residential mortgage loans, net, consisted of the following (in thousands):

	June 30, 2001	December 31, 2000
1-4 unit residential mortgage loans	$ 948,547	$ 971,145
Purchase discounts and premiums, net	7,503	6,894
Allowance for loan losses	(7,657)	(7,641)
Total residential mortgage loans, net	$ 948,393	$ 970,398

Residential mortgage loans consist primarily of adjustable rate mortgages ("ARMs") which adjust periodically based on changes in various indices including the FHLB Eleventh District Cost of Funds, the one-year Treasury rate and the six-month Treasury rate. Certain types of residential mortgage loans contain an option for the mortgagor to convert the ARM to a fixed rate loan for the remainder of the term. Included in residential mortgage loans are hybrid ARMs, which have an initial three or five-year fixed rate period, followed by annual interest rate adjustments. As of June 30, 2001 and December 31, 2000, approximately 54% and 46%, respectively, of residential mortgage loans consisted of such hybrid ARMs.

(3) Dividends

Holders of Series A Preferred Shares (as defined herein) are entitled to receive, if, when and as authorized and declared by the Board of Directors of the Company out of funds legally available, noncumulative dividends at a rate of 9 1/8% per annum of the initial liquidation preference ($25.00 per share). Dividends on the Series A Preferred Shares, if authorized and declared, are payable quarterly in arrears on the last day of March, June, September and December. Dividends paid during each of the six month periods ended June 30, 2001 and 2000 to the holders of the Series A Preferred Shares totalled approximately $22.8 million.

Dividends on common stock are paid if, when and as authorized and declared by the Board of Directors out of funds legally available after all preferred dividends have been paid. There were no common stock dividends paid during the six months ended June 30, 2001 or 2000.

(4) Related Party Transactions

The Company entered into a servicing agreement with First Nationwide Mortgage Corporation ("FNMC") pursuant

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to which FNMC performs the actual servicing of the residential mortgage loans held by the Company in accordance with normal industry practice (the "Servicing Agreement"). The Servicing Agreement can be terminated without cause with at least 30 days prior written notice to FNMC and payment to FNMC of a termination fee equal to 2% of the outstanding principal balances of the loans. The servicing fee ranges from 0.25% to 0.50% per year of the outstanding principal balances. Servicing fee expense paid totalled $1.8 million for each of the six months ended June 30, 2001 and 2000, respectively. Servicing fee expense paid totalled $910,000 and $913,000 for the three months ended June 30, 2001 and 2000, respectively. FNMC is also entitled to a 1% disposition fee on the aggregate proceeds obtained in the sale of a defaulted residential mortgage loan. The Company recorded such disposition fees totalling approximately $5,000 and $10,000 during the six months ended June 30, 2001 and 2000, respectively. The Company recorded such disposition fees totalling approximately $4,000 and $3,000 during the three months ended June 30, 2001 and 2000, respectively. These disposition fees are included in other noninterest expense in the accompanying statements of income.

In its capacity as servicer, FNMC holds mortgage loan payments received on behalf of the Company in a custodial account at the Bank. The balance of this account totalled approximately $39.8 million and $15.1 million at June 30, 2001 and December 31, 2000, respectively, and is included in due from affiliates. Substantially all of such payments were passed through to the

Company in July 2001 and January 2001, respectively, as provided in the Servicing Agreement. At June 30, 2001 and December 31, 2000, trust funds of approximately $1.9 million and $1.4 million, respectively, representing escrows received from borrowers, were on deposit in a trust account at the Bank and are not included in the accompanying financial statements.

As of June 30, 2001 and December 31, 2000, the Company owed the Bank approximately $410,000 and $56,000, respectively, in connection with the settlement of loans purchased from the Bank, advances related to foreclosed real estate and expenses incurred by the Company to be reimbursed to the Bank. These amounts were paid to the Bank during July 2001 and January 2001, respectively.

(5) Newly Issued Accounting Pronouncements

Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

On September 29, 2000, the FASB issued Statement of Financial Accounting Standards No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities ("SFAS No. 140"). SFAS No. 140 replaces SFAS No. 125, which was issued in June of 1996. It revises the standards for accounting for securitizations and other transfers of financial assets and collateral and requires certain disclosures, but it carries over most of the provisions of SFAS No. 125 without reconsideration. In general, SFAS No. 140 was effective for transfers of financial assets occurring after March 31, 2001 and for disclosures relating to securitization transactions and collateral for fiscal years ending after December 15, 2000.

The implementation of SFAS No. 140 did not materially impact the Company's financial results.

Recognition of Interest Income and Impairment on Purchased and Returned Beneficial Interests in Securitized Financial Assets

On September 21, 2000, the Emerging Issues Task Force ("EITF") issued EITF No. 99-20, Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets ("EITF No. 99-20"). This document, which was effective on April 1, 2001, establishes guidance for (1) recognizing interest income (including amortization of premiums or discounts) on (a) all credit-sensitive mortgage and asset-backed securities and (b) certain prepayment-sensitive securities including agency interest-only strips and (2) determining when these securities must be written down to fair value because of impairment. Existing GAAP did not provide interest recognition and impairment guidance for securities on which cash flows change as a result of both prepayments and credit losses and, in some cases, interest rate adjustments.

The implementation of EITF No. 99-20 did not materially impact the Company's financial results.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements. This Report contains forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, that pertain to our future operating results. Words such as "anticipate," "believe," "expect," "intend," and other similar expressions are intended to identify these statements. Forward-looking statements are not historical facts and are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control. Our actual results could differ materially from those in the forward-looking statements due to such factors as (i) the Company's dependence upon the operations of its affiliated servicer and upon the financial condition and operations of its parent, California Federal Bank; (ii) regulatory restrictions on the Company's operations; (iii) interest rate changes; (iv) declines in real estate values and increases in uncollected or uncollectable mortgage loans; (v) the concentration of the Company's portfolio in loans secured by residential properties located in California; (vi) the inclusion of high balance mortgage loans in the Company's portfolio; (vii) changes made by the Company's Board of Directors in the Company's investment and operating policies and strategies, including whether or not to incur indebtedness; and (viii) failure to qualify as a real estate investment trust for federal income tax purposes. In January 1997, we filed an S-11 Registration Statement with the SEC that discusses these factors in greater detail. We assume no obligation to update any of our forward-looking statements.

FINANCIAL HIGHLIGHTS

The following information is presented as of June 30, 2001 and for the six and three months ended June 30, 2001 and 2000 (dollars in thousands):

	2001	2000
Statements of Income - Six Months Ended June 30:		
Net interest income	$ 34,659	$34,207
Net income	$ 34,622	$34,193
Average yield on mortgage loans	6.89%	6.80%
Statements of Income - Three Months Ended June 30:		
Net interest income	$ 16,901	$17,294
Net income	$ 16,890	$17,320
Average yield on mortgage loans	6.71%	6.85%
Balance Sheet as of June 30, 2001:		
Residential mortgage loans, net	$ 948,393	
Total assets	$1,012,343	
Total stockholders' equity	$1,011,661	

OVERVIEW

The Company's principal business objective is to acquire, hold and manage residential mortgage loans that will generate net income for distribution to stockholders. The Company currently intends to invest in residential mortgage loans only. The Company's current policy prohibits the acquisition of any mortgage loan which is delinquent at the time of the proposed acquisition or which meets certain criteria for non-performance during the preceding 12 months. The Company currently expects that substantially all of the residential mortgage loans to be acquired will be conventional or hybrid adjustable rate loans; however, the Company may from time to time acquire fixed interest rate residential mortgage loans. The Company anticipates it will continue to acquire all of its residential mortgage loans from the Bank or affiliates of the Bank as whole loans secured by first mortgages or deeds of trust on 1-4 unit residential real estate properties, although mortgage loans may be acquired from unaffiliated third parties. The Company may from time to time acquire fixed rate or variable rate mortgage-backed securities issued or guaranteed by agencies of the federal government or government sponsored agencies. The mortgage loans underlying the mortgage-backed securities will be secured by single-family residential, multifamily or commercial real estate properties located throughout the United States.

On January 31, 1997, the Company commenced its operations upon the initial public offering of 20,000,000 shares of the Company's 9 1/8% Noncumulative Exchangeable Preferred Stock, Series A (the "Series A Preferred Shares"), which raised $500 million. The Series A Preferred Shares are traded on the New York Stock Exchange under the trading symbol "CFP." Concurrent with the sale of the Series A Preferred Shares, the Bank contributed additional capital of $500 million to the Company. All common shares are held by the Bank.

RESULTS OF OPERATIONS

Six months ended June 30, 2001 versus six months ended June 30, 2000

Net Income. The Company reported net income for the six months ended June 30, 2001 of $34.6 million compared with net income of $34.2 million for the corresponding period in 2000. This increase in 2001 compared with 2000 is attributable to an increase in net interest income.

During each of the six month periods ended June 30, 2001 and 2000, the Company declared and paid dividends of $22.8 million on the outstanding Series A Preferred Shares. Net income available to the common stockholder for the six months ended June 30, 2001 and 2000 totalled $11.8 million and $11.4 million, respectively. There were no common stock dividends paid during the six months ended June 30, 2001 or 2000.

Net Interest Income. The Company reported interest income, net of servicing fee expense, for the six months ended June 30, 2001 of $34.7 million, an increase of $452,000 from the $34.2 million reported for the six month period ended June 30, 2001. This increase in interest income is attributed to a higher average yield on the residential mortgage loan portfolio. The higher yield of 6.89% on residential mortgage loans during the six month period ended June 30, 2001 as compared to the 6.80% yield for the same period in 2000 is primarily due to the lagging effect of the repricing of variable rate loans at higher rates. The average outstanding balance of residential mortgage loans during the six month period ended June 30, 2001 was $964,000 higher than during the same period in 2000. Interest income, net of servicing fee expense, during the six months ended June 30, 2001 is comprised of $34.2 million ($36.0 million gross interest less $1.8 million servicing fee expense) from residential mortgage loans and $446,000 from short-term investments, representing an average yield after servicing fees on residential mortgage loans of 6.89% and on earning assets of 6.84%, based on average outstanding asset balances of $993.8 million and $1,012.9 million, respectively. Interest income, net of servicing fee expense, during the six months ended June 30, 2000 is comprised of $33.8 million ($35.6 million gross interest less $1.8 million servicing fee expense) from residential mortgage loans and $447,000 from short-term investments, representing an average yield after servicing fees on residential mortgage loans of 6.80% and on earning assets of 6.78%, based on average outstanding asset balances of $992.9 million and $1,009.5 million, respectively.

The computation of the average yield on residential mortgage loans and on earning assets is based on daily average outstanding asset balances that include nonaccruing loans and the amount of principal payments collected by FNMC but not yet remitted to the Company, which is included in due from affiliates on the balance sheets.

Provision for Loan Losses. The Company recorded no provision for loan losses in either of the six month periods ended June 30, 2001 and 2000. The determination to record no provision for loan losses during these periods is the result of management's evaluation of the adequacy of the allowance for loan losses based on, among other things, the Bank's and the Company's past loan loss experience, known and inherent risks in the residential mortgage loan portfolio, adverse situations that have occurred but are not yet known and that may affect the borrower's ability to repay, the estimated value of the underlying collateral, and economic conditions.

Three months ended June 30, 2001 versus three months ended June 30, 2000

Net Income. The Company reported net income for the three months ended June 30, 2001 of $16.9 million compared with net income of $17.3 million for the corresponding period in 2000. This decrease in 2001 compared with 2000 is attributable to a decrease in net interest income.

During each of the three month periods ended June 30, 2001 and 2000, the Company declared and paid dividends of $11.4 million on the outstanding Series A Preferred Shares. Net income available to the common stockholder for the three months ended June 30, 2001 and 2000 totalled $5.5 million and $5.9 million, respectively. There were no common stock dividends paid during the three months ended June 30, 2001 or 2000.

Net Interest Income. The Company reported interest income, net of servicing fee expense, for the three months ended June 30, 2001 of $16.9 million, a decrease of $393,000 from the $17.3 million reported for the three month period ended June 30, 2000. This decrease in interest income is attributed to a lower average yield on the residential mortgage loan portfolio. The lower yield of 6.71% on residential mortgage loans during the three month period ended June 30, 2001 as compared to the 6.85% yield for the same period in 2000 is primarily due to the repricing of variable rate loans at lower rates during 2001 and the purchase of new loans at lower current market rates. The average outstanding balance of residential mortgage loans during the three month period ended June 30, 2001 was $439,000 higher than during the same period in 2000. Interest income, net of servicing fee expense, during the three months ended June 30, 2001 is comprised of $16.7 million ($17.6 million gross interest less $910,000 servicing fee expense) from residential mortgage loans and $241,000 from short-term investments, representing an average yield after servicing fees on residential mortgage loans of 6.71% and on earning assets of 6.65%, based on average outstanding asset balances of $993.5 million and $1,016.4 million, respectively. Interest income, net of servicing fee expense, during the three months ended June 30, 2000 is comprised of $17.0 million ($17.9 million gross interest less $913,000 servicing fee expense) from residential mortgage loans and $275,000 from short-term investments, representing an average yield after servicing fees on residential mortgage loans of 6.85% and on earning assets of 6.83%, based on average outstanding asset balances of $993.1 million and $1,013.0 million, respectively.

The computation of the average yield on residential mortgage loans and on earning assets is based on daily average outstanding asset balances that include nonaccruing loans and the amount of principal payments collected by FNMC but not yet remitted to the Company, which is included in due from affiliates on the balance sheets.

Provision for Loan Losses. The Company recorded no provision for loan losses in either of the three month periods ended June 30, 2001 and 2000. The determination to record no provision for loan losses during these periods is the result of management's evaluation of the adequacy of the allowance for loan losses based on, among other things, the Bank's and the Company's past loan loss experience, known and inherent risks in the residential mortgage loan portfolio, adverse situations that have occurred but are not yet known and that may affect the borrower's ability to repay, the estimated value of the underlying collateral, and economic conditions.

RESIDENTIAL MORTGAGE LOANS

The Company reinvests principal collections in additional residential mortgage loans purchased from either the Bank or its affiliates on a periodic basis.

It is the Company's policy to place a loan on nonaccrual when a borrower is 90 days or more delinquent. There were no accruing loans contractually past due 90 days or more at June 30, 2001 or December 31, 2000.

The following table reflects residential mortgage loans with past due principal and interest payments as of June 30, 2001 and December 31, 2000:

	June 30, 2001		Dec
	Principal Balance (in thousands)	Percent of Total Loans	Principal Ba (in thousa
30 to 59 days past due	$ 767	0.08%	$1,775
60 to 89 days past due	2,493	0.26	1,162
90 days or more past due	1,877	0.20	1,628
	$5,137	0.54%	$4,565

ALLOWANCE FOR LOAN LOSSES

As of June 30, 2001, the Company has allocated $321,000 of its allowance for loan losses against specific problem loans, with the remaining $7.3 million available to absorb potential loan losses from the entire residential mortgage loan portfolio. The Company deems its allowance for loan losses as of June 30, 2001 to be adequate. Although the Company believes that it has sufficient allowances to absorb losses which currently exist in the portfolio, the amount is subject to

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continuing review based on quality indicators, industry and geographic concentrations, changes in business conditions, and other external factors such as competition, legal and regulatory requirements. The Company will continue to periodically reassess the adequacy of the allowance for loan losses.

The following table reflects the activity in the Company's allowance for loan losses for the six months ended June 30, 2001 and 2000 (in thousands):

	2001	2000
Balance - January 1	$ 7,641	$ 7,883
Provision for loan losses	--	--
Recoveries (charge-offs), net	16	(162)
Balance - June 30	$ 7,657	$ 7,721

The Company's allowance coverage ratio (allowance for loan losses to loans) at June 30, 2001 and December 31, 2000 was 0.80% and 0.78%, respectively.

INTEREST RATE RISK

The Company's income consists primarily of interest payments on residential mortgage loans. The Company anticipates that most of its residential mortgage loans will bear interest at adjustable rates. If there is a decline in interest rates (as measured by the indices upon which the interest rates of the residential mortgage loans are based), then the Company will experience a decrease in income available to be distributed to its stockholders. In such an interest rate environment the Company may experience an increase in prepayments on its residential mortgage loans and may find it more difficult to purchase additional residential mortgage loans bearing rates sufficient to support payment of the dividends on the Series A Preferred Shares. In addition, certain residential mortgage loan products which the Company holds will allow borrowers in such an interest rate environment to convert an adjustable rate mortgage to a fixed rate mortgage, thus "locking in" a lower fixed interest rate. Because the dividend rate on the Series A Preferred Shares is fixed, there can be no assurance that an interest rate environment in which there is a significant decline in interest rates would not adversely affect the Company's ability to pay such dividends.

Residential mortgage loans which have interest rates that adjust monthly based upon the FHLB Eleventh District Cost of Funds limit payment changes to no more than 7.5% of the payment amount per year. This may lead to monthly payments which are less than the amount necessary to amortize the loan to maturity at the interest rate in effect for any particular month. In the event that the monthly payment is not sufficient to pay interest accruing on the loan during the month, this deficiency is added to the loan's principal balance (i.e., negative amortization). The total outstanding principal balance for a particular loan is generally not allowed to exceed 125% of the original loan amount as a result of negative amortization. Every five years and at any time the loan reaches its maximum amount, the loan payment is recalculated to the payment sufficient to repay the unpaid balance in full at the maturity date. Approximately $141.4 million and $172.2 million of the residential mortgage loans held by the Company at June 30, 2001 and December 31, 2000, respectively, had the potential to negatively amortize, while approximately $14.2 million and $18.9 million of the residential mortgage loans had negatively amortized such that the current principal balance of the loan exceeded the original principal balance at June 30, 2001 and December 31, 2000, respectively. The current principal balance exceeded the original principal balance on those loans by approximately $542,000 and $712,000 as of June 30, 2001 and December 31, 2000, respectively. If there is an increase in interest rates on such residential mortgage loans (as measured by the indices upon which the interest rates of the residential mortgage loans are based), where such increase in the interest rate does not coincide with a corresponding adjustment of the borrower's monthly payment, the Company may experience a decrease in cash available to be distributed to its common stockholder.

SIGNIFICANT CONCENTRATION OF CREDIT RISK

Certain geographic regions of the United States from time to time may experience natural disasters or weaker regional economic conditions and housing markets and, consequently, may experience higher rates of loss and delinquency on residential mortgage loans generally. Any concentration of the residential mortgage loans in such a region may present risks in addition to those generally present with respect to residential mortgage loans.

The Company's exposure to geographic concentrations directly affects the credit risk of the residential mortgage loans within the portfolio. The following table shows the residential mortgage loan portfolio by geographical area as of June 30, 2001:

	Book Value (in thousands)	Percent
California	$ 792,684	82.9%
Florida	23,991	2.5
New York	17,376	1.8
Nevada	15,310	1.6
Texas	11,576	1.2
Colorado	10,787	1.1
Hawaii	10,345	1.1
Washington	10,338	1.1
Other states (31 states and Washington, D.C.; no state has more than 1%)	63,643	6.7
	$ 956,050	100.0%

The 82.9% of the Company's total residential mortgage loan portfolio comprised of loans secured by residential real estate properties located in California may be subject to a greater risk of default than other comparable residential mortgage loans in the event of natural hazards or other adverse conditions in California that may affect the ability of residential property owners in California to make payments of principal and interest on underlying mortgages. There is evidence of deterioration in some real estate markets, especially in northern California. As of June 30, 2001, 40.9% of the Company's total residential mortgage loan portfolio was comprised of loans secured by properties located in northern California.

LIQUIDITY RISK MANAGEMENT

The objective of liquidity management is to ensure the availability of sufficient cash flows to meet all of the Company's financial commitments and to capitalize on opportunities for the Company's business expansion. In managing liquidity, the Company takes into account various legal limitations placed on a Real Estate Investment Trust ("REIT"). See "--Other Matters."

The Company's principal liquidity needs are to maintain the current portfolio size through the acquisition of additional residential mortgage loans and to pay dividends on the Series A Preferred Shares. The acquisition of additional residential mortgage loans is funded with the proceeds obtained from repayment of principal balances by individual mortgagees. The payment of dividends on the Series A Preferred Shares will be made from legally available funds, principally arising from the operating activities of the Company. The Company's cash flows from operating activities principally consist of the collection of interest on the residential mortgage loans. The Company does not have and does not anticipate having any material capital expenditures.

In order to remain qualified as a REIT, the Company must distribute annually at least 90% of its REIT taxable income, as provided for under the Internal Revenue Code ("IRC"), to its common and preferred stockholders. Prior to 2001, the Company was required to distribute 95% of its REIT taxable income. The Company currently expects to distribute dividends annually to satisfy these REIT requirements.

The Company anticipates that cash and cash equivalents on hand and the cash flow from the residential mortgage loans will provide adequate liquidity for its operating, investing and financing needs.

As presented in the accompanying statement of cash flows, the primary sources of funds during the six months ended June 30, 2001 were $36.8 million provided by operating activities and $151.4 million provided by mortgage loan principal repayments. The primary uses of funds were $154.9 million in purchases of mortgage loans and $22.8 million in preferred stock dividends paid.

OTHER MATTERS

As of June 30, 2001, the Company was in full compliance with the REIT tax rules and believes that it will continue to qualify as a REIT under the provisions of the IRC. The Company calculates:

a. its Qualified REIT Assets, as defined in the Code, to be 97% of its total assets, as compared to the Federal tax requirements that at least 75% of its total assets must be Qualified REIT assets; and

b. that 99% of its revenue qualifies for the 75% source of income test and 100% of its revenue qualifies for the 95% source of income test under the REIT rules.

The Company also met all REIT requirements regarding the ownership of its stock and anticipates meeting the annual distribution requirements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in reported market risks faced by the Company since the Company's report in Item 7A of its Form 10-K for the year ended December 31, 2000.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company is not the subject of any material litigation. None of the Company, the Bank or any of its affiliates is currently involved in nor, to the Company's knowledge, is currently threatened with, any material litigation with respect to the residential mortgage loans included in the portfolio other than routine litigation arising in the ordinary course of business, most of which is covered by liability insurance.

ITEM 6. EXHIBITS AND CURRENT REPORTS ON FORM 8-K

(a) Exhibits:

3.1 Amended and Restated Charter of the Registrant (Incorporated by reference to Exhibit 3.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 1997).

3.1 By-laws of the Registrant, as amended (Incorporated by reference to Exhibit 3(b) to Amendment No. 2 to the Registrant's Registration Statement on Form S-11 (File No. 333-11609)).

(b) Reports on Form 8-K:

No Current Reports on Form 8-K were filed during the quarter ended June 30, 2001.

SIGNATURE

Pursuant to the requirements 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.

California Federal Preferred Capital Corporation

/s/ Richard H.Terzian

By: Richard H. Terzian
Executive Vice President, Chief Financial Officer and Director

(Signing on behalf of the Registrant and as the Principal Financial Officer)

August 7, 2001