DOWNEY FINANCIAL CORP
Form 10-K
March 07, 2001

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)
|X| Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2000.

|X| Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from ______________ to ______________.

Commission File Number 1-13578

DOWNEY FINANCIAL CORP.
(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of incorporation or organization)

3501 Jamboree Road, Newport Beach, California 92660
(Address of principal executive offices) (Zip Code)

I.R.S. Employer Identification No.: 33-0633413

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

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

TITLE OF EACH CLASS	NAME OF EACH EXCHANGE
Common Stock, $0.01 par value	New York Stock Exchange Pacific Exchange

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

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

Indicate by a 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. |_|

The aggregate market value of the voting stock held by non-affiliates of the registrant, based upon the closing sale price of its Common Stock on February 28, 2001, on the New York Stock Exchange was $923,319,826.

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

DOCUMENTS INCORPORATED BY REFERENCE: Portions of the Registrant's Proxy Statement to be filed with the Securities and Exchange Commission in connection with the Annual Meeting of Stockholders to be held April 25, 2001 are incorporated by reference in Part III hereof.

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PART I

Certain matters discussed in this Annual Report may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the "Reform Act") and, as such, may involve risks and uncertainties. These forward-looking statements relate to, among other

things, expectations of the business environment in which Downey Financial Corp. ("Downey," "we," "us" and "our") operates, projections of future performance, perceived opportunities in the market and statements regarding Downey's mission and vision. Downey's actual results, performance or achievements may differ significantly from the results, performance or achievements expressed or implied in such forward-looking statements. For discussion of the factors that might cause such a difference, see Business--Factors That May Affect Future Results on page 20.

ITEM 1. BUSINESS

GENERAL

We were incorporated in Delaware on October 21, 1994. On January 23, 1995, after we obtained necessary stockholder and regulatory approvals, we acquired 100% of the issued and outstanding capital stock of Downey Savings and Loan Association (the "Bank") and the Bank's stockholders became holders of our stock. Downey was thereafter funded by the Bank and presently operates as the Bank's holding company. Our stock is traded on the New York Stock Exchange and Pacific Exchange under the trading symbol "DSL."

The Bank was formed in 1957 as a California-licensed savings and loan association and converted to a federal charter in 1995. As of December 31, 2000, it conducts its business through 114 retail deposit branches, including 49 full-service in-store branches. Residential loans are originated by residential loan officers who work out of 46 of the Bank's California retail deposit branches. Residential loan officers also originate residential loans through the Internet from two California call centers. Wholesale loans submitted by mortgage brokers are originated from six California loan origination centers, two of which are located in or by a Bank office.

The Bank is regulated or affected by the following governmental entities and laws:

- As a federally chartered savings association, the Bank's activities and investments are generally governed by the Home Owners' Loan Act, as amended, and regulations and policies of the Office of Thrift Supervision (the "OTS").

- The Bank and Downey are subject to the primary regulatory and supervisory jurisdiction of the OTS.

- As a federally insured depository institution, the Bank is regulated and supervised by the Federal Deposit Insurance Corporation (the "FDIC") with respect to some of its activities and investments.

- The Bank is a member of the Federal Home Loan Bank (the "FHLB") of San Francisco, which is one of the 12 regional banks for federally insured depository institutions comprising the Federal Home Loan Bank System.

- The Bank's savings deposits are insured through the Savings Association Insurance Fund ("SAIF") of the FDIC, an instrumentality of the United States government.

- The Bank is regulated by the Federal Reserve with respect to reserves the Bank is required to maintain against deposits and other matters.

General economic conditions, the monetary and fiscal policies of the federal government and the regulatory policies of governmental authorities significantly influence our operations. Additionally, interest rates on competing investments and general market interest rates influence our deposit flows and the costs we incur on interest-bearing liabilities, which represents

our cost of funds. Similarly, market interest rates and other factors that affect the supply of and demand for housing and the availability of funds affect our loan volume and our yields on loans and mortgage-backed securities.

Our primary business is banking and we are also involved in real estate investments, each of which we discuss further below.

BANKING ACTIVITIES

Our primary business is banking. Our banking activities focus on:

- attracting funds from the general public and institutions; and
- originating and investing in loans, primarily residential real estate mortgage loans, investment securities and mortgage-backed securities.

These mortgage-backed securities include mortgage pass-through securities issued by other entities and securities issued or guaranteed by government-sponsored enterprises like the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and the Government National Mortgage Association.

Our primary sources of revenue from our banking business are:

- interest we earn on loans, investment securities and mortgage-backed securities;
- fees we earn in connection with loans and deposits;
- gains on sales of our loans, investment securities and mortgage-backed securities; and
- income we earn on loans and mortgage-backed securities we service for investors.

Our principal expenses in connection with our banking business are:

- interest we incur on our interest-bearing liabilities, including deposits, borrowings and capital securities; and
- general and administrative costs.

Our primary sources of funds from our banking business are:

- deposits;
- principal and interest payments on our loans and mortgage-backed securities;
- proceeds from sales of our loans and mortgage-backed securities; and
- borrowings and capital securities.

Scheduled payments we receive on our loans and mortgage-backed securities are a relatively stable source of funds. However, the funds we receive from deposits and prepayment of loans and mortgage-backed securities vary widely. Below is a detailed discussion of our banking activities.

LENDING ACTIVITIES

Historically, our lending activities have primarily emphasized our origination of first mortgage loans secured by residential properties and retail neighborhood shopping centers. To a lesser extent, our lending activities have emphasized our origination of real estate loans secured by multi-family and commercial and industrial properties, including office buildings, land and other properties with income producing capabilities. In addition, we have provided construction loan financing for single family and multi-family residential properties and commercial retail neighborhood shopping center projects. These construction loan financings have included loans to joint ventures, which were being engaged in by DSL Service Company, a wholly owned subsidiary of the Bank, with other participants. We also originate loans to businesses through our commercial banking operations.

We originate automobile loans directly through our branch network. We also conducted an indirect auto-lending program through our purchase of new or used automobile sales contracts from auto dealers in California and other western states. Downey Auto Finance Corp., a previous wholly owned subsidiary of the Bank, operated this indirect auto-lending program, but was sold in February 2000. For more information, see Management's Discussion and Analysis of Financial Condition and Results of Operations--Financial Condition--Sale of Subsidiary on page 61.

Our primary focus will continue to be our origination of:

- adjustable rate single family mortgage loans, including subprime loans which carry higher interest rates; and

- consumer loans.

We will also continue our secondary marketing activities of originating and selling single family loans to various investors.

For more information, see below under the caption entitled Secondary Marketing and Loan Servicing Activities on page 5. For additional information on the composition of our loan and mortgage-backed securities portfolio, see Management's Discussion and Analysis of Financial Condition and Results of Operations--Financial Condition--Loans and Mortgage-Backed Securities on page 35.

LOAN AND MORTGAGE-BACKED SECURITIES PORTFOLIO

We carry loans receivable held for investment at cost. Our net loans receivable are adjusted for amortization of premiums and accretion of discounts which are recognized in interest income using the interest method. Our investments in mortgage-backed securities represent participating interests in pools of first mortgage loans originated and serviced by the issuers of the securities. We carry mortgage-backed securities held to maturity at unpaid principal balances, which are adjusted for unamortized premiums and unearned discounts. We amortize premiums and discounts on mortgage-backed securities by using the interest method over the remaining period to contractual maturity, adjusted for anticipated prepayments.

We identify loans that may be sold before their maturity. In our balance sheets, we classify these as loans held for sale and record them at the lower of amortized cost or market value. We recognize net unrealized losses on these loans, if any, in a valuation allowance by making charges to our income.

We carry mortgage-backed securities available for sale at fair value. We report net unrealized gains or losses on these securities net of income taxes in stockholders' equity and as a separate component of our other comprehensive income until realized.

The residential mortgage loans we originate typically have contractual maturities at origination of 15 to 40 years. To limit the interest rate risk associated with these 15- to 40-year maturities, we, among other things, principally originate adjustable rate mortgages for our own loan portfolio. We originate fixed rate loans with the intention to sell the majority of them in the secondary market on a non-recourse basis for cash. However, we occasionally originate fixed rate loans for our own portfolio to facilitate the sale of real estate we acquire in settlement of loans or which meet specific yield and other approved guidelines. For more information, see Asset/Liability Management on page 8. In addition, the average term of these fixed rate mortgage loans we originate for our own portfolio historically has been significantly shorter than their contractual maturity due to loan payoffs as a result of home sales or refinancings and prepayments.

RESIDENTIAL REAL ESTATE LENDING

Our primary lending activity is our origination of mortgage loans secured by single family residential properties consisting of one-to-four units located primarily in California. We provide these mortgage loans for borrowers to purchase residences or to refinance their existing mortgages at lower rates or upon different terms. Our primary strategy is to originate adjustable rate mortgages for our portfolio of loans we hold for investment. For more information, see Asset/Liability Management on page 8. We also originate residential fixed rate mortgage loans to meet consumer demand, but we intend to sell the majority of these loans in the secondary market, rather than hold them in our portfolio. We may, however, place residential fixed rate loans in our portfolio of loans held for investment if these fixed rate loans are funded with long-term funds to mitigate interest rate risk. In addition, we originate a small volume of fixed rate loans for our own investment if they meet specific yield and other approved guidelines or to facilitate our sale of real estate acquired in settlement of loans. For more information, see Secondary Marketing and Loan Servicing Activities on page 5.

Our adjustable rate mortgages generally:

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

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

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

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

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

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

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

Regarding negative amortization, if a loan incurs significant negative amortization, then there is an increased risk that the market value of the underlying collateral on the loan would be insufficient to satisfy fully the outstanding principal and interest. We currently impose a limit on the amount of negative amortization, so that the principal plus the added amount cannot exceed 110% of the original loan amount. In the past, the limit was 125% on loans with an original loan-to-value ratio of 80% or less. A loan-to-value ratio is the ratio of the principal amount of the loan to the appraised value at origination of the property securing the loan. At year-end 2000, loans with the higher limit on negative amortization represented about one-third of our adjustable rate one-to-four unit residential portfolio. We permit adjustable rate mortgages to be assumed by qualified borrowers.

During 2000, approximately 87% of our one-to-four unit residential real estate loans were obtained by our wholesale loan representatives but originated through outside mortgage brokers. We pay our wholesale loan representatives on a commission basis. We consider the compensation we pay outside mortgage brokers when we set the overall price of our mortgage loan products. These mortgage brokers do not operate from our offices and are not our employees. Our retail loan account representatives generated approximately 13% of our one-to-four unit residential loans during 2000. We compensate our retail loan account representatives located in our call centers on a salary basis plus a fixed amount per loan they originate. Retail loan account representatives located in our branch offices are compensated on a commission only basis. Retail loan account representatives typically receive loan referrals from real estate agents, builders and customers. Our call centers receive loan referrals from retail advertising and other sources, including over the Internet.

We require that our residential real estate loans be approved at various levels of management, depending upon the amount of the loan. On a single family residential loan we originate for our portfolio, the maximum amount we generally will lend is $1 million. Our average loan size, however, is much lower. In 2000, our average loan size was $260,210. We generally make loans with loan-to-value ratios not exceeding 80%. We will make loans with loan-to-value ratios of over 80%, but not exceeding 97% of the value of the property, if the borrower obtains private mortgage insurance to reduce the effective loan-to-value ratio to between 70% to 78%, consistent with secondary marketing requirements. In addition, we require that borrowers obtain hazard insurance for all residential real estate loans covering the lower of the loan amount or the replacement value of the residence.

In our approval process for the loans we originate or purchase, we assess both the value of the property securing the loan and the applicant's ability to repay the loan. Loan underwriters analyze the loan application and the property involved. Qualified appraisers on our staff or outside appraisers establish the value of the collateral through the use of full appraisals or alternative valuation formats that meet regulatory requirements. Appraisal reports prepared by outside appraisers are selectively reviewed by our staff appraisers or by approved fee appraisers. We also obtain information about the applicant's income, financial condition, employment and credit history. Typically, we will verify an applicant's credit information for loans originated by our retail loan representatives. For loans submitted from outside mortgage brokers, we require the mortgage broker to obtain, review and verify the applicant's credit information and employment. In addition, in underwriting and qualifying the loan

applicant, we obtain credit information about the applicant and perform other underwriting tests of these broker-originated loans.

On our adjustable rate mortgages we offer with incentive interest rates, we qualify applicants:

- for loan programs with no negative amortization at the higher of:
  - the initial incentive interest rate; or
  - the fully indexed interest rate.
- for loan programs that include negative amortization and are owner occupied, at the minimum qualifying interest rate of 7.50%.

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- for loan programs that include negative amortization and are non-owner occupied, at the minimum qualifying interest rate of 7.75%.

Late in 1996, we began offering one-to-four unit residential loans to borrowers who have or, in the case of purchases, will have equity in their homes but whose credit rating contains exceptions which preclude them from qualifying for lower or better market interest rates and terms. We refer to these lower grade credits, which we characterize as "A-," "B" and "C" loans, as subprime loans in our loan portfolio. Our subprime loans are characterized by lower loan-to-value ratios and higher average interest rates than higher credit grade loans or "A" loans. We believe these lower credit grade borrowers represent an opportunity for us to earn a higher net return for the risks we assume. We have developed specific underwriting guidelines for each classification of subprime credit and qualify these applicants at the fully indexed rate. For further information, see Regulation--Regulation of the Bank--Regulatory Capital Requirements on page 13.

SECONDARY MARKETING AND LOAN SERVICING ACTIVITIES

As part of our secondary marketing activities, we originate some residential real estate adjustable rate mortgages and fixed rate mortgages, which we intend to sell. Accordingly, we classify these loans as held for sale and carry them at the lower of cost or market. These loans are secured by first liens on one-to-four unit residential properties and generally have maturities of 30 years or less.

Generally, we use various hedging programs to manage the interest rate risk of our fixed rate mortgage origination process. For further information, see Asset/Liability Management on page 8.

We believe that servicing loans for others can be an important asset/liability management tool because it produces operating results which, in response to changes in market interest rates, tend to move opposite to changes in net interest income. Because adjustable rate mortgages take longer to adjust to market interest rates, net interest income associated with these loans is expected to decline in periods of rising interest rates and increase in periods of falling rates. In contrast, the value of a loan servicing portfolio normally:

- increases as interest rates rise and loan prepayments decrease; and
- declines as interest rates fall and loan prepayments increase.

In addition, increased levels of servicing activities and the opportunity to

offer our other financial services in servicing loans for others can provide us with additional income with minimal additional overhead costs.

Depending upon market pricing for servicing, we sell loans either servicing retained or servicing released. When we sell loans servicing retained, we record gains or losses from these loans at the time of sale. We calculate gains or losses from our sale as the difference between the net sales proceeds and the allocated basis of the loans sold. We capitalize mortgage servicing rights we acquire through either our purchase or origination of mortgage loans we intend to sell with servicing rights retained. We allocate the total cost of the mortgage loans designated for sale to both the mortgage servicing rights and to the mortgage loans without mortgage servicing rights based on their relative fair values. We disclose our mortgage servicing rights in our financial statements and include them as a component of the gain on sale of loans. We recognize impairment losses on the mortgage servicing rights through a valuation allowance and record any associated provision as a component of loan servicing fees. At December 31, 2000, our mortgage servicing rights totaled $41 million.

We may exchange loans we originate for sale with government agencies for mortgage-backed securities collateralized by these loans. Our cost for the exchange, a monthly guaranty fee, is expressed as a percentage of the unpaid principal balance and is deducted from interest income. We can use the securities we receive to collateralize various types of our borrowings at rates that frequently are more favorable than rates on other types of liabilities and also carry a lower risk-based capital requirement than whole loans. We carry these mortgage-backed securities available for sale at fair value. However, we record no gain or loss on the exchange in our statement of income until the securities are sold to a third party. Before we sell these securities to third parties, we show all changes in fair value as a separate component of stockholders' equity as accumulated other comprehensive income, net of income taxes.

COMMERCIAL REAL ESTATE AND MULTI-FAMILY LENDING

We have provided permanent loans secured by retail neighborhood shopping centers and multi-family properties. Our major loan officers conduct our commercial real estate and multi-family lending activities. We compensate these officers on a salary basis.

Commercial real estate and multi-family loans generally entail additional risks as compared to single family residential mortgage lending. We subject each loan, including loans to facilitate the sale of real estate we own, to our underwriting standards, which generally include:

- our evaluation of the creditworthiness and reputation of the borrower; and

- the amount of the borrower's equity in the project as determined on the basis of appraisal, sales and leasing information on the property and cash flow projections.

To protect the value of the security for our loan, we require borrowers to maintain casualty insurance for the loan amount or replacement cost. In addition, for non-residential loans in excess of $500,000, we require the borrower to obtain comprehensive general liability insurance. All commercial real estate loans we originate must be approved by at least two of our officers, one of whom must be the originating loan account officer and the other a designated officer with appropriate loan approval authority.

CONSTRUCTION LENDING

We have provided construction loan financing for single family and multi-family residential properties and commercial real estate projects, like retail neighborhood shopping centers. Our major loan officers principally originate these loans. We generally make construction loans at floating interest rates based upon the prime or reference rate of a major commercial bank. Generally, we require a loan-to-value ratio of 75% or less on construction lending and we subject each loan to our underwriting standards.

Construction loans involve risks different from completed project lending because we advance loan funds based upon the security of the completed project under construction. If the borrower defaults on the loan, then we may have to advance additional funds to finance the project's completion before the project can be sold. Moreover, construction projects are affected by uncertainties inherent in estimating:

- construction costs;
- potential delays in construction time;
- market demand; and
- the accuracy of the estimate of value on the completed project.

When providing construction loans, we require the general contractor to, among other things, carry contractor's liability insurance equal to specific prescribed minimum amounts, carry builder's risk insurance and have a blanket bond against employee misappropriation.

COMMERCIAL LENDING

We originate commercial loans and revolving lines of credit and issue standby letters of credit for our middle market commercial customers. We offer the various credit products on both a secured and unsecured basis with interest rates being either fixed or variable. Our portfolio emphasis is toward secured, floating rate credit facilities. Our commercial banking group directs these activities and focuses on our long-term, relationship-based customers. We also utilize our retail branch network as a source of commercial customers, with the lending to these customers being typically managed by the branch manager. We believe our commercial borrowers are desirable because these borrowers generally have lower cost deposit accounts.

CONSUMER LENDING

Until its sale in February 2000, we originated fixed rate automobile loans through an indirect lending program of Downey Auto Finance Corp. which used preapproved automobile dealers to finance consumer purchases of new and used automobiles. For additional information regarding Downey Auto Finance Corp., see Management's Discussion and Analysis of Financial Condition and Results of Operations--Financial Condition--Sale of Subsidiary on page 61.

In addition, the Bank originates direct automobile loans, home equity loans and lines of credit, and other consumer loan products. Before we make a consumer loan, we assess the applicant's ability to repay the loan and, if applicable, the value of the collateral securing the loan. The risk involved with home equity loans and lines of credit is similar to the risk involved with

residential real estate loans. We offer customers a credit card through a third party, who extends the credit and services the loans made to our customers.

INVESTMENT ACTIVITIES

Federal and state regulations require the Bank to maintain a specified minimum amount of liquid assets invested in particular short-term obligations and other securities. For additional information regarding liquidity requirements and the Bank's compliance with the liquidity requirements, see Regulation--Regulation of the Bank--Liquidity Requirements on page 19 and Management's Discussion and Analysis of Financial Condition and Results of Operations--Financial Condition--Capital Resources and Liquidity on page 57. As a federally chartered savings association, the Bank's ability to make other securities investments is prescribed under the OTS regulations and the Home Owners' Loan Act. The Bank's authorized officers make investment decisions within guidelines established by the Bank's Board of Directors. The Bank manages these investments in an effort to produce the highest yield, while at the same time maintaining safety of principal, minimizing interest rate risk and complying with applicable regulations.

We carry securities held to maturity at amortized cost. We adjust these costs for amortization of premiums and accretion of discounts, which we recognize as interest income using the interest method. We carry securities available for sale at fair value. We exclude unrealized holding gains and losses, or valuation allowances established for net unrealized losses, from our earnings and report them as a separate component of our stockholders' equity as accumulated other comprehensive income, net of income taxes, unless the security is deemed other than temporarily impaired. If the security is determined to be other than temporarily impaired, we charge the amount of the impairment to operations. For further information on the composition of our investment portfolio, see Management's Discussion and Analysis of Financial Condition and Results of Operations--Financial Condition--Investment Securities on page 38.

DEPOSIT ACTIVITIES

We prefer to use deposits as our principal source of funds for supporting our lending activities, because the cost of these funds generally is less than that of borrowings or other funding sources with comparable maturities. We traditionally have obtained our savings deposits primarily from areas surrounding the Bank's California branch offices. However, we occasionally raise some retail deposits through Wall Street activities.

General economic conditions affect deposit flows. Funds may flow from depository institutions such as savings associations into direct vehicles like government and corporate securities or other financial intermediaries. Our ability to attract and retain deposits will continue to be affected by money market conditions and prevailing interest rates. Generally, state or federal regulation does not restrict interest rates we pay on deposits.

In 1996, we began establishing full-service branch facilities in selected supermarket locations throughout California. Each in-store branch offers a full range of financial services including checking and savings accounts as well as residential and consumer loans.

When consistent with our maintenance of appropriate capital levels, we may consider opportunities to augment our retail branch system and deposit base through our acquisition of selected branches or deposits.

For further information, see Management's Discussion and Analysis of Financial Condition and Results of Operations--Financial Condition--Deposits on page 41.

BORROWING ACTIVITIES

Our principal source of funds has been and continues to be deposits we raise through our retail branch system. At various times, however, we have utilized other sources to fund our loan origination and other business activities. We have at times relied upon our borrowings from the FHLB of San Francisco as an additional source of funds. The FHLB of San Francisco makes advances to us through several different credit programs it offers.

From time to time, we obtain additional sources of funds by selling some of our securities and mortgage loans under agreements to repurchase. These reverse repurchase agreements are generally short-term and are

collateralized by our mortgage-backed or investment securities and our mortgage loans. We only deal with investment banking firms that are recognized as primary dealers in U.S. government securities or major commercial banks in connection with these reverse repurchase agreements. In addition, we limit the amounts of our borrowings from any single institution.

For further information, see Management's Discussion and Analysis of Financial Condition and Results of Operations--Financial Condition--Borrowings on page 43.

CAPITAL SECURITIES

On July 23, 1999, we issued $120 million in capital securities through Downey Financial Capital Trust I. The capital securities pay quarterly cumulative cash distributions at an annual rate of 10.00% of the liquidation value of $25 per share. Of the $115 million of net proceeds, we invested $108 million as additional common stock of the Bank thereby increasing the Bank's regulatory core/tangible capital by that same amount. The balance of the net proceeds have been used for general corporate purposes. For further information regarding our capital securities, see Note 19 on page 93 of Notes to Consolidated Financial Statements.

ASSET/LIABILITY MANAGEMENT

Savings institutions are affected by interest rate risks to the degree that their interest-bearing liabilities, consisting principally of customer deposits, FHLB advances, other borrowings and capital securities, mature or reprice on a different basis than their interest-earning assets, which consist predominantly of intermediate or long-term real estate loans. While having liabilities that on average mature or reprice more frequently than assets may be beneficial in times of declining interest rates, this asset/liability structure may result in declining net earnings during periods of rising interest rates. One of our principal objectives is to manage the effects of adverse changes in interest rates on our interest income while maintaining our asset quality and an acceptable interest rate spread. To improve the rate sensitivity and maturity balance of our interest-earning assets and liabilities, we have emphasized the origination of loans with adjustable interest rates or relatively short maturities. Loans with adjustable interest rates have the beneficial effect of allowing the yield on our assets to increase during periods of rising interest rates, although these loans have contractual limitations on the frequency and extent of interest rate adjustments.

For further information see Lending Activities on page 2 and Management's Discussion and Analysis of Financial Condition and Results of Operations--Financial Condition--Asset/Liability Management and Market Risk on

page 44.

EARNINGS SPREAD

We determine our net interest income or the interest rate spread by calculating the difference between:

- the yield we earn on our interest-earning assets like loans, mortgage-backed securities and investment securities; and
- the cost we pay on our interest-bearing liabilities like deposits, borrowings and capital securities.

Our net interest income is also determined by the relative dollar amounts of our interest-earning assets and interest-bearing liabilities.

Our effective interest rate spread, which reflects the relative level of our interest-earning assets to our interest-bearing liabilities, equals:

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

For information regarding our net income and the components thereof and for management's analysis of our financial condition and results of operations, see Management's Discussion and Analysis of Financial Condition and Results of Operations beginning on page 26. For information regarding the return on our assets and other selected financial data see Selected Financial Data on page 24.

INSURANCE AGENCY ACTIVITIES

Downey Affiliated Insurance Agency was incorporated on January 25, 1995, as Downey's wholly owned subsidiary. We capitalized Downey Affiliated Insurance Agency on February 24, 1995 with $400,000. In the 1995 second quarter, Downey Affiliated Insurance Agency commenced operations at which time representatives of Downey Affiliated Insurance Agency were available in our branches to offer annuity products. During 1996, Downey Affiliated Insurance Agency began offering forced-placed casualty insurance policies on mortgage loans and stopped offering annuity products. The offering of forced-placed casualty insurance policies ceased in April 1999.

REAL ESTATE INVESTMENT ACTIVITIES

In addition to our primary business of banking, which has been described above, we are also involved in real estate investment activities, which are conducted primarily through DSL Service Company, a wholly owned subsidiary of the Bank. DSL Service Company is a diversified real estate development company which was established in 1966 as a neighborhood shopping center and residential tract developer, as well as the general contractor for the Bank's branch locations. Today its capabilities include development, construction and property management activities relating to its portfolio of projects primarily within California, but also in Arizona. In addition to DSL Service Company developing its own real estate projects, it associates with other qualified developers to engage in joint ventures. The primary revenue sources of our real estate investment activities include net rental income and gains from the sale of real estate investments. The primary expenses of our real estate investment activities are interest expense and general and administrative expense.

Before Congress passed the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"), the Bank conducted real estate development and joint venture operations directly, in addition to operations conducted through DSL Service Company. Since FIRREA, however, the Bank's ability to engage in new real estate development and joint venture activities and to retain its existing real estate investments was curtailed dramatically. In addition, these activities may be economically unfeasible for the Bank because of the capital requirements FIRREA imposes on these activities. FIRREA requires, with some limited exceptions, a savings institution like the Bank to exclude from the Bank's regulatory capital:

- the Bank's investments in, and extensions of credit to, real estate subsidiaries like DSL Service Company; and
- the Bank's direct equity investments in real estate development and joint venture operations.

FIRREA also prohibits the Bank from making new investments in real estate development and joint venture operations.

The Bank is required to deduct the full amount of its investment in DSL Service Company in calculating its applicable ratios under the core, tangible and risk-based capital standards. Savings associations generally may invest in service corporation subsidiaries, like DSL Service Company, to the extent of 2% of the association's assets, plus up to an additional 1% of assets for investments which serve primarily community, inner-city or community development purposes. In addition, "conforming loans" by the Bank to DSL's joint venture partnerships are limited to 50% of the Bank's risk-based capital. "Conforming loans" are those generally limited to 80% of appraised value, bear a market rate of interest and require payments sufficient to amortize the principal balance of the loan. We are in compliance with each of these investment limitations.

To the extent Downey or a subsidiary of Downey, other than the Bank or its subsidiaries, makes real estate investments, the above-mentioned capital deductions and limitations do not apply as they only pertain to the specific investments by savings associations or their subsidiaries.

For further information, see Management's Discussion and Analysis of Financial Condition and Results of Operations--Financial Condition--Investments in Real Estate and Joint Ventures on page 39.

COMPETITION

We face competition both in attracting deposits and in making loans. Our most direct competition for deposits has historically come from other savings institutions and from commercial banks located in our principal market areas, including many large financial institutions based in other parts of the country or their subsidiaries. In addition, we face additional significant competition for investors' funds from short-term money market securities

and other corporate and government securities. Our ability to attract and retain savings deposits depends, generally, on our ability to provide a rate of return, liquidity and risk comparable to that offered by competing investment opportunities and the appropriate level of customer service.

We experience competition for real estate loans principally from other savings institutions, commercial banks, mortgage banking companies and insurance

companies. We compete for loans principally through our interest rates and loan fees we charge and our efficiency and quality of services we provide borrowers and real estate brokers.

EMPLOYEES

At December 31, 2000, we had approximately 1,294 full-time employees and 489 part-time employees. We provide our employees with health and welfare benefits and a retirement and savings plan. Additionally, we offer qualifying employees participation in our stock purchase plan. Our employees are not represented by any union or collective bargaining group, and we consider our employee relations to be good.

REGULATION

GENERAL

Federal and state law extensively regulates savings and loan holding companies and savings associations. This regulation is intended primarily for the protection of our depositors and the SAIF and not for the benefit of our stockholders. In the following information, we describe some of the regulations applicable to us and the Bank. We do not claim this discussion is complete and qualify our discussion in its entirety by reference to applicable statutory or regulatory provisions.

REGULATION OF DOWNEY

General. We are a savings and loan holding company. We are subject to regulatory oversight by the OTS. Thus, we are required to register and file reports with the OTS and are regulated and examined by the OTS. In addition, the OTS has enforcement authority over us, which also permits the OTS to restrict or prohibit our activities that it determines to be a serious risk to the Bank.

Activities Restrictions. As a savings and loan holding company with only one savings and loan association subsidiary, we generally are not limited by OTS activity restrictions, provided the Bank satisfies the qualified thrift lender test or meets the definition of a domestic building and loan association in the Internal Revenue Code. If we acquire control of another savings association as a separate subsidiary of Downey, we would become a multiple savings and loan holding company. As a multiple savings and loan holding company, our activities, other than the activities of the Bank or any other SAIF-insured savings association, would become subject to restrictions applicable to bank holding companies unless these other savings associations were acquired in a supervisory acquisition and each also satisfies the qualified thrift lender test or meets the definition of a domestic building and loan association. Furthermore, if we were in the future to sell control of the Bank to any other company, such company would not succeed to our grandfathered status as a unitary thrift holding company and would be subject to the same business activity restrictions as a bank holding company. For more information, see Recent Legislation on page 11 and Regulation of the Bank--Qualified Thrift Lender Test on page 15.

On October 27, 2000, the OTS issued a proposed rule that would require some savings and loan holding companies to notify the OTS 30 days before undertaking certain significant new business activities. As proposed, holding companies would have to give the OTS advance notice of:

- the incurrence of debt, when combined with all other transactions by the company or any subsidiaries other than the thrift during the past 12 months, increases non-thrift liabilities by 5 percent or more; and non-thrift liabilities, after the debt transaction, equal 50 percent or more of the company's consolidated core capital;

- an asset acquisition or series of such transactions by the company or non-thrift subsidiary during the past 12 months that involves assets other than cash, cash equivalents and securities or other obligations guaranteed by the U.S. Government and exceeds 15 percent of the company's consolidated assets; and

- any transaction that, when combined with all other transactions during the past 12 months, reduces the company's capital by 10 percent or more.

Exempt from the notice requirement would be any holding company with consolidated subsidiary thrift assets of less than 20 percent of total assets or consolidated holding company capital of at least 10 percent. The OTS could object to or conditionally approve an activity or transaction if it finds a material risk to the safety and soundness and stability of the thrift. The review period could be extended an additional 30 days if necessary.

The OTS proposal also would codify current practices and the factors relevant to a holding company's need for capital. To determine the need for and level of an explicit holding company capital requirement, the OTS will look at overall risk at the thrift and the consolidated entity, their tangible and equity capital, whether the holding company's debt-to-capital ratio is rising, what investments or activities are funded by debt, its cash flow, how much the holding company relies on dividends from its subsidiary thrift to service debt or fulfill other obligations, earnings volatility and the thrift's standing in the corporate structure.

The comment period for the proposed rule was extended to February 9, 2001. It is not possible at this time to predict the impact of the proposed rule on our financial condition or results of operation.

Restrictions on Acquisitions. We must obtain approval from the OTS before acquiring control of any other SAIF-insured association. The OTS generally prohibits these types of acquisitions if they result in a multiple savings and loan holding company controlling savings associations in more than one state. However, the OTS permits interstate acquisitions if the acquisition is authorized by specific state authorization or a supervisory acquisition of a failing savings association.

Federal law generally provides that no "person," acting directly or indirectly or through or in concert with one or more other persons, may acquire "control" of a federally insured savings association unless the person gives at least 60 days written notice to the OTS. The OTS then has the opportunity to disapprove the proposed acquisition. In addition, no company may acquire control of this type of an institution without prior OTS approval. These provisions also prohibit, among other things, any director or officer of a savings and loan holding company, or any individual who owns or controls more than 25% of the voting shares of a savings and loan holding company, from acquiring control of any savings association not a subsidiary of the savings and loan holding company, unless the acquisition is approved by the OTS.

Recent Legislation. On November 12, 1999, the Gramm-Leach-Bliley Act of 1999 (the "Financial Services Modernization Act") was signed into law. The Financial Services Modernization Act repeals the two affiliation provisions of the Glass-Steagall Act:

- Section 20, which restricted the affiliation of Federal Reserve member banks with firms "engaged principally" in specified securities

activities; and

- Section 32, which restricts officer, director or employee interlocks between a member bank and any company or person "primarily engaged" in specified securities activities.

In addition, the Financial Services Modernization Act contains provisions that expressly preempt any state law restricting the establishment of financial affiliations, primarily related to insurance. The general effect of the law is to establish a comprehensive framework to permit affiliations among commercial banks, insurance companies, securities firms and other financial service providers by revising and expanding the Bank Holding Company Act framework to permit a holding company to engage in a full range of financial activities through a new entity known as a "Financial Holding Company." "Financial activities" is broadly defined to include not only banking, insurance and securities activities, but also merchant banking and additional activities that the Federal Reserve Board, in consultation with the Secretary of the Treasury, determines to be financial in nature, related or incidental to such financial activities, or complementary activities that do not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally.

The Financial Services Modernization Act provides that no company may acquire control of an insured savings association, unless that company engages, and continues to engage, only in the financial activities permissible for a Financial Holding Company, unless grandfathered as a unitary savings and loan holding company. The Financial Institution Modernization Act grandfathers any company that was a unitary savings and loan holding company on May 4, 1999 or became a unitary savings and loan holding company pursuant to an application pending on that date. Downey is a grandfathered unitary savings and loan holding company and we

may continue to operate under present law as long as we continue to control only the Bank and the Bank continues to meet the qualified thrift lender test.

We do not believe that the Financial Services Modernization Act will have a material adverse effect on our operations in the near-term. However, to the extent that the act permits banks, securities firms and insurance companies to affiliate, the financial services industry may experience further consolidation. The Financial Services Modernization Act is intended to grant to community banks certain powers as a matter of right that larger institutions have accumulated on an ad hoc basis and which unitary savings and loan holding companies, such as Downey, already possess. Nevertheless, this act may have the result of increasing the amount of competition that we face from larger institutions and other types of companies offering financial products, many of which may have greater financial resources than we do. In addition, the Financial Services Modernization Act may have an anti-takeover effect because it may tend to limit the range of potential acquirers of Downey to other savings and loan holding companies and Financial Holding Companies.

REGULATION OF THE BANK

General. The OTS and the FDIC extensively regulate the Bank because the Bank is a federally chartered, SAIF-insured savings association. The Bank must ensure that its lending activities and its other investments comply with various statutory and regulatory requirements. The Bank is also regulated by the Federal Reserve.

The OTS, in conjunction with the FDIC, regularly examines the Bank and prepares reports for the Bank's Board of Directors to consider with respect to any deficiencies the OTS or the FDIC finds in the Bank's operations. Federal and state laws also regulate the relationship between the Bank and its depositors and borrowers, especially in matters regarding the ownership of savings accounts and the form and content of mortgage documents used by the Bank.

The Bank must file reports with the OTS and the FDIC concerning its activities and financial condition. In addition, the Bank must obtain regulatory approvals before entering into some transactions like mergers with or acquisitions of other financial institutions. This regulation and supervision establishes a comprehensive framework of activities in which an institution may engage and is intended primarily for the protection of the SAIF and our depositors. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. Any change in regulations, whether by the OTS, the FDIC or the Congress, could have a material adverse impact on us, the Bank and our operations.

Insurance of Deposit Accounts. The SAIF, as administered by the FDIC, insures the Bank's deposit accounts up to the maximum amount permitted by law. The FDIC may terminate insurance of deposits upon a finding that the institution:

- has engaged in unsafe or unsound practices;
- is in an unsafe or unsound condition to continue operations; or
- has violated any applicable law, regulation, rule, order or condition imposed by the FDIC or the institution's primary regulator.

The FDIC charges an annual assessment for the insurance of deposits based on the risk a particular institution poses to its deposit insurance fund. Under this system as of December 31, 2000, SAIF members paid within a range of 0 cents to 27 cents per $100 of domestic deposits, depending upon the institution's risk classification. This risk classification is based on an institution's capital group and supervisory subgroup assignment.

The Bank also pays, in addition to its normal deposit insurance premium as a member of the SAIF, an amount equal to approximately 0.0212% of insured deposits toward the retirement of the Financing Corporation bonds (known as FICO Bonds) issued in the 1980s to assist in the recovery of the savings and loan industry. These assessments will continue until the FICO Bonds mature in 2017.

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Regulatory Capital Requirements. The Bank must meet regulatory capital standards to be deemed in compliance with OTS capital requirements. OTS capital regulations require savings associations to meet the following three capital standards:

- tangible capital equal to 1.5% of total adjusted assets;
- leverage capital, or "core capital," equal to 3% of total adjusted assets for institutions such as the Bank; and
- risk-based capital equal to 8.0% of total risk-based assets.

A savings association with a greater than "normal" level of interest rate exposure must deduct an interest rate risk component in calculating its total capital for purposes of determining whether it meets its risk-based capital requirement. Interest rate exposure is measured, generally, as equal to:

- the decline in an institution's net portfolio value that would result from a 200 basis point increase or decrease in market interest rates, whichever would result in a lower net portfolio value, divided by

- the estimated economic value of the savings association's assets.

The interest rate risk component a savings association must deduct from its total capital is equal to:

- one-half of the difference between an institution's measured exposure and "normal" interest rate risk exposure, which the OTS defines as 2%, multiplied by

- the estimated economic value of the institution's assets.

In August 1995, the OTS indefinitely delayed implementation of its interest rate risk regulation. However, based on the asset/liability structure of the Bank, at December 31, 2000, the Bank would not have been required to deduct an interest rate risk component in calculating its total risk-based capital had OTS's interest rate risk regulation been in effect.

The OTS views its capital regulation requirements as minimum standards, and it expects most institutions to maintain capital levels well above the minimum. In addition, the OTS regulations provide that the OTS may establish minimum capital levels higher than those provided in the regulations for individual savings associations, upon a determination that the savings association's capital is or may become inadequate in view of its circumstances. The OTS regulations provide that higher individual minimum regulatory capital requirements may be appropriate in circumstances where, among others:

- a savings association has a high degree of exposure to interest rate risk, prepayment risk, credit risk, concentration of credit risk, other risks arising from nontraditional activities, or similar risks or a high proportion of off-balance sheet risk;

- a savings association is growing, either internally or through acquisitions, at a rate that presents supervisory issues; or

- a savings association may be adversely affected by activities or condition of its holding company, affiliates, subsidiaries or other persons, or savings associations with which it has significant business relationships.

The Bank is not required to meet any individual minimum regulatory capital requirement. At December 31, 2000, the Bank's regulatory capital exceeded all minimum regulatory capital requirements.

As a result of a number of federally insured financial institutions extending their risk selection standards to attract lower credit quality accounts due to their having higher interest rates and fees, the federal banking regulatory agencies jointly issued Interagency Guidelines on Subprime Lending in March 1999. In addition, expanded guidelines were issued by the agencies on January 31, 2001. Subprime lending involves extending credit to individuals with less than perfect credit histories.

The agencies' guidelines consider subprime lending a high-risk activity that is unsafe and unsound if the risks associated with subprime lending are not

properly controlled. Specifically, the 2001 guidelines direct examiners to

expect regulatory capital one and one-half to three times higher than that typically set aside for prime assets for institutions that:

- have subprime assets equal to 25% or higher of Tier 1 capital, or
- have subprime portfolios experiencing rapid growth or adverse performance trends, are administered by inexperienced management, or have inadequate or weak controls.

Our subprime portfolio, pursuant to our definition, represented 250% of Tier 1 capital as of year-end 2000. Any requirement for us to maintain additional regulatory capital as a result of our activities in subprime lending could have an adverse affect on our future prospects and operations and may restrict our ability to grow. If we are unable to comply with any new capital requirements imposed upon regulatory examination, we may be subject to the prompt corrective action regulations of the OTS. Although we believe we maintain appropriate controls and regulatory capital for our subprime activities, we cannot determine whether, or to what extent, additional capital requirements will be imposed on us after periodic examinations by the OTS.

The Home Owners' Loan Act permits savings associations not in compliance with the OTS capital standards to seek an exemption from penalties or sanctions for noncompliance. The OTS will grant an exemption only if the savings association meets strict requirements. In addition, the OTS must deny the exemption in some circumstances. If the OTS does grant an exemption, the savings association still may be exposed to enforcement actions for other violations of law or unsafe or unsound practices or conditions.

Prompt Corrective Action. The OTS's prompt corrective action regulation requires the OTS to take mandatory actions and authorizes the OTS to take discretionary actions against a savings association that falls within undercapitalized capital categories specified in the regulation.

The regulation establishes five categories of capital classification:

- "well capitalized;"
- "adequately capitalized;"
- "undercapitalized;"
- "significantly undercapitalized;" and
- "critically undercapitalized."

The regulation uses an institution's risk-based capital, leverage capital and tangible capital ratios to determine the institution's capital classification. At December 31, 2000, the Bank exceeded the capital requirements of a well capitalized institution under applicable OTS regulations.

Loans-to-One-Borrower. Savings associations generally are subject to the lending limits applicable to national banks. With limited exceptions, the maximum amount that a savings association or a national bank may lend to any borrower, including some related entities of the borrower, at one time may not exceed:

- 15% of the unimpaired capital and surplus of the institution, plus

- an additional 10% of unimpaired capital and surplus if the loans are fully secured by readily marketable collateral.

Savings associations are additionally authorized to make loans to one borrower, for any purpose:

- in an amount not to exceed $500,000; or

- by order of the Director of OTS, in an amount not to exceed the lesser of $30,000,000 or 30% of unimpaired capital and surplus to develop residential housing, provided:

  - the purchase price of each single-family dwelling in the development does not exceed $500,000;

  - the savings association is in compliance with its capital requirements;

  - the loans comply with applicable loan-to-value requirements; and

  - the aggregate amount of loans made under this authority does not exceed 15% of unimpaired capital and surplus.

At December 31, 2000, the Bank's loans-to-one-borrower limit was $112 million based upon the 15% of unimpaired capital and surplus measurement.

Qualified Thrift Lender Test. The OTS requires savings associations to meet a qualified thrift lender test. The qualified thrift lender test may be met either by maintaining a specified level of assets in qualified thrift investments as specified in the Home Owners' Loan Act or by meeting the definition of a "domestic building and loan association." Qualified thrift investments are primarily residential mortgages and related investments, including some mortgage-related securities. The required percentage of investments under the Home Owners' Loan Act is 65% of assets while the Internal Revenue Code requires investments of 60% of assets. An association must be in compliance with the qualified thrift lender test or the definition of domestic building and loan association on a monthly basis in nine out of every 12 months. Associations failing to meet the qualified thrift lender test are generally allowed only to engage in activities permitted for both national banks and savings associations.

The FHLB also relies on the qualified thrift lender test. A savings association will only enjoy full borrowing privileges from an FHLB if the savings association is a qualified thrift lender. As of December 31, 2000, the Bank was in compliance with its qualified thrift lender test requirement and met the definition of a domestic building and loan association.

Affiliate Transactions. Transactions between a savings association and its "affiliates" are quantitatively and qualitatively restricted under the Federal Reserve Act. Affiliates of a savings association include, among other entities, the savings association's holding company and companies that are under common control with the savings association.

In general, a savings association or its subsidiaries are limited in their ability to engage in "covered transactions" with affiliates:

- to an amount equal to 10% of the association's capital and surplus, in the case of covered transactions with any one affiliate; and

- to an amount equal to 20% of the association's capital and surplus, in the case of covered transactions with all affiliates.

In addition, a savings association and its subsidiaries may engage in covered transactions and other specified transactions only on terms and under circumstances that are substantially the same, or at least as favorable to the savings association or its subsidiary, as those prevailing at the time for comparable transactions with nonaffiliated companies. A "covered transaction" includes:

- a loan or extension of credit to an affiliate;

- a purchase of investment securities issued by an affiliate;

- a purchase of assets from an affiliate, with some exceptions;

- the acceptance of securities issued by an affiliate as collateral for a loan or extension of credit to any party; or

- the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate.

In addition, under the OTS regulations:

- a savings association may not make a loan or extension of credit to an affiliate unless the affiliate is engaged only in activities permissible for bank holding companies;

- a savings association may not purchase or invest in securities of an affiliate other than shares of a subsidiary;

- a savings association and its subsidiaries may not purchase a low-quality asset from an affiliate;

- covered transactions and other specified transactions between a savings association or its subsidiaries and an affiliate must be on terms and conditions that are consistent with safe and sound banking practices; and

- with some exceptions, each loan or extension of credit by a savings association to an affiliate must be secured by collateral with a market value ranging from 100% to 130%, depending on the type of collateral, of the amount of the loan or extension of credit.

The OTS regulations generally exclude all non-bank and non-savings association subsidiaries of savings associations from treatment as affiliates, except to the extent that the OTS or the Federal Reserve decides to treat these subsidiaries as affiliates. The regulations also require savings associations to make and retain records that reflect affiliate transactions in reasonable detail and provides that specified classes of savings associations may be required to give the OTS prior notice of affiliate transactions.

Capital Distribution Limitations. OTS regulations impose limitations upon all capital distributions by savings associations, like cash dividends, payments to repurchase or otherwise acquire its shares, payments to shareholders of

another institution in a cash-out merger and other distributions charged against capital. The OTS recently adopted an amendment to these capital distribution limitations. Under the new rule, a savings association in some circumstances may:

- be required to file an application and await approval from the OTS before it makes a capital distribution;
- be required to file a notice 30 days before the capital distribution; or
- be permitted to make the capital distribution without notice or application to the OTS.

The OTS regulations require a savings association to file an application if:

- it is not eligible for expedited treatment of its other applications under OTS regulations;
- the total amount of all of capital distributions, including the proposed capital distribution, for the applicable calendar year exceeds its retained net income for that year to date plus retained net income for the preceding two years;
- it would not be at least adequately capitalized, under the prompt corrective action regulations of the OTS following the distribution; or
- the association's proposed capital distribution would violate a prohibition contained in any applicable statute, regulation or agreement between the savings association and the OTS, or the FDIC, or violate a condition imposed on the savings association in an OTS-approved application or notice.

In addition, a savings association must give the OTS notice of a capital distribution if the savings association is not required to file an application, but:

- would not be well capitalized under the prompt corrective action regulations of the OTS following the distribution;
- the proposed capital distribution would reduce the amount of or retire any part of the savings association's common or preferred stock or retire any part of debt instruments like notes or debentures

included in capital, other than regular payments required under a debt instrument approved by the OTS; or

- the savings association is a subsidiary of a savings and loan holding company.

If neither the savings association nor the proposed capital distribution meet any of the above listed criteria, the OTS does not require the savings association to submit an application or give notice when making the proposed capital distribution. The OTS may prohibit a proposed capital distribution that would otherwise be permitted if the OTS determines that the distribution would constitute an unsafe or unsound practice.

Privacy. Under the Financial Services Modernization Act, federal banking regulators are required to adopt rules that will limit the ability of banks and other financial institutions to disclose non-public information about consumers to nonaffiliated third parties. Federal banking regulators issued final rules on May 10, 2000. Pursuant to those rules, financial institutions must provide:

- initial notices to customers about their privacy policies, describing the conditions under which they may disclose nonpublic personal information to nonaffiliated third parties and affiliates;
- annual notices of their privacy policies to current customers; and
- a reasonable method for customers to "opt out" of disclosures to nonaffiliated third parties.

The rules were effective November 13, 2000, but compliance is optional until July 1, 2001. These privacy provisions will affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors. Although it is not possible at this time to assess the impact of the privacy provisions on our financial condition or results of operations, we do not believe that the Privacy provisions will have a material adverse impact on our operations in the near term.

Consumer Protection Rules - Sale of Insurance Products. In December 2000, pursuant to the requirements of the Financial Services Modernization Act, the federal bank and thrift regulatory agencies adopted consumer protection rules for the sale of insurance products by depository institutions. The rule is effective on April 1, 2001. The final rule applies to any depository institution or any person selling, soliciting, advertising or offering insurance products or annuities to a consumer at an office of the institution or on behalf of the institution. Before an institution can complete the sale of an insurance product or annuity, the regulation requires oral and written disclosure that such product:

- is not a deposit or other obligation of, or guaranteed by, the depository institution or its affiliate;
- is not insured by the FDIC or any other agency of the United States, the depository institution or its affiliate; and
- has certain risks in investment, including the possible loss of value.

Finally, the depository institution may not condition an extension of credit:

- on the consumer's purchase of an insurance product or annuity from the depository institution or from any of its affiliates, or
- on the consumer's agreement not to obtain, or a prohibition on the consumer from obtaining, an insurance product or annuity from an unaffiliated entity.

The rule also requires formal acknowledgement from the consumer that disclosures were received.

In addition, to the extent practicable, a depository institution must keep insurance and annuity sales activities physically segregated from the areas where retail deposits are routinely accepted from the general public.

Safeguarding Confidential Customer Information. In January 2000, the banking agencies adopted guidelines requiring financial institutions to establish an information security program to:

- identify and assess the risks that may threaten customer information;
- develop a written plan containing policies and procedures to manage and control these risks;
- implement and test the plan; and
- adjust the plan on a continuing basis to account for changes in technology, the sensitivity of customer information, and internal or external threats to information security.

Each institution may implement a security program appropriate to its size and complexity and the nature and scope of its operations.

The guidelines outline specific security measures that institutions should consider in implementing a security program. A financial institution must adopt those security measures determined to be appropriate. The guidelines require the board of directors to oversee an institution's efforts to develop, implement and maintain an effective information security program and approve written information security policies and programs. The guidelines are effective July 1, 2001.

Activities of Subsidiaries. A savings association seeking to establish a new subsidiary, acquire control of an existing company or conduct a new activity through a subsidiary must provide 30 days prior notice to the FDIC and the OTS and conduct any activities of the subsidiary in compliance with regulations and orders of the OTS. The OTS has the power to require a savings association to divest any subsidiary or terminate any activity conducted by a subsidiary that the OTS determines to pose a serious threat to the financial safety, soundness or stability of the savings association or to be otherwise inconsistent with sound banking practices.

Community Reinvestment Act and the Fair Lending Laws. Savings associations have a responsibility under the Community Reinvestment Act and related regulations of the OTS to help meet the credit needs of their communities, including low- and moderate-income neighborhoods. In addition, the Equal Credit Opportunity Act and the Fair Housing Act prohibit lenders from discriminating in their lending practices on the basis of characteristics specified in those statutes. An institution's failure to comply with the provisions of the Community Reinvestment Act could, at a minimum, result in regulatory restrictions on its activities and the denial of applications. In addition, an institution's failure to comply with the Equal Credit Opportunity Act and the Fair Housing Act could result in the OTS, other federal regulatory agencies as well as the Department of Justice taking enforcement actions.

Federal Home Loan Bank System. The Bank is a member of the FHLB system. Among other benefits, each FHLB serves as a reserve or central bank for its members within its assigned region. Each FHLB is financed primarily from the sale of consolidated obligations of the FHLB system. Each FHLB makes available loans or advances to its members in compliance with the policies and procedures established by the Board of Directors of the individual FHLB.

As an FHLB member, the Bank is required to own capital stock in an FHLB in an amount equal to the greater of:

- 1% of its aggregate outstanding principal amount of its residential mortgage loans, home purchase contracts and similar obligations at the

beginning of each calendar year;

- 5% of its FHLB advances or borrowings; or
- $500.

The Bank's required investment in FHLB stock, based on December 31, 2000 financial data, was $99 million. At December 31, 2000, the Bank had $106 million of FHLB stock.

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Liquidity Requirements. Under OTS regulations, a savings association is required to maintain an average daily balance of liquid assets. These liquid assets include cash, some time deposits and savings accounts, bankers' acceptances, some government obligations and other investments. The OTS requires a savings association to maintain an average daily balance of liquid assets in each calendar quarter of not less than 4% of either:

- its liquidity base, which consists of some net withdrawable accounts plus short-term borrowings, as of the end of the preceding calendar quarter; or
- the average daily balance of its liquidity base during the preceding quarter.

The OTS may change this liquidity requirement from time to time to any amount between 4% and 10%, depending upon factors, including economic conditions and savings flows of all savings associations. The Bank maintains liquid assets in compliance with these regulations. The OTS may impose monetary penalties upon an institution for violations of liquidity requirements.

Federal Reserve System. The Federal Reserve requires all depository institutions to maintain non- interest-bearing reserves at specified levels against their transaction accounts and non-personal time deposits. These transaction accounts include checking, NOW and Super NOW checking accounts. The balances a savings association maintains to meet the reserve requirements imposed by the Federal Reserve may be used to satisfy the liquidity requirements that are imposed by the OTS. At December 31, 2000, the Bank was in compliance with these requirements.

REGULATION OF DSL SERVICE COMPANY

DSL Service Company is licensed as a real estate broker under the California Real Estate Law and as a contractor with the Contractors State License Board. Thus, the real estate investment activities of DSL Service Company, including development, construction and property management activities relating to its portfolio of projects, are governed by a variety of laws and regulations. Changes in the laws and regulations or their interpretation by agencies and the courts occur frequently. DSL Service Company must comply with various federal, state and local laws, ordinances, rules and regulations concerning zoning, building design, construction, hazardous waste and similar matters. Environmental laws and regulations also affect the operations of DSL Service Company, including regulations pertaining to availability of water, municipal sewage treatment capacity, land use, protection of endangered species, population density and preservation of the natural terrain and coastlines. These and other requirements could become more restrictive in the future, resulting in additional time and expense in connection with DSL Service Company's real estate activities.

With regard to environmental matters, the construction products industry is regulated by federal, state and local laws and regulations pertaining to several areas including human health and safety and environmental compliance. The Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended by the Superfund Amendments and Reauthorization Act of 1986, as well as analogous laws in some states, create joint and several liability for the cost of cleaning up or correcting releases to the environment of designated hazardous substances. Among those who may be held jointly and severally liable are:

- those who generated the waste;
- those who arranged for disposal;
- those who owned or operated the disposal site or facility at the time of disposal; and
- current owners.

In general, this liability is imposed in a series of governmental proceedings initiated by the government's identification of a site for initial listing as a "Superfund site" on the National Priorities List or a similar state list and the government's identification of potentially responsible parties who may be liable for cleanup costs. None of the DSL Service Company's project sites are listed as a "Superfund site."

In addition, California courts have imposed warranty-like responsibility upon developers of new housing for defects in structure and the housing site, including soil conditions. This responsibility is not necessarily dependent upon a finding that the developer was negligent.

As a licensed entity, DSL Service Company is also examined and supervised by the California Department of Real Estate and the Contractors State License Board.

TAXATION

Federal. A savings institution is taxed like other corporations for federal income tax purposes, though savings institutions have historically enjoyed favorable treatment under the Internal Revenue Code in determining their deductions for bad debts.

Savings institutions are required to comply with income tax statutes and regulations similar to those applicable to large commercial banks. The Bank's bad debt deduction is determined under the specific charge-off method, which allows the Bank to take an income tax deduction for these loans only when they have been determined to be wholly or partially worthless.

In addition to the regular corporate income tax, corporations might be required to pay an alternative minimum tax. This tax is computed at 20% of the corporation's regular taxable income, after taking some adjustments into account. This alternative tax applies to corporations to the extent that it exceeds a corporation's regular tax liability.

A corporation that incurs alternative minimum tax generally is entitled to take this tax as a credit against its regular tax in later years to the extent that the corporation's regular tax liability in these later years exceeds the corporation's alternative minimum tax.

State. The Bank uses California's financial corporation income tax rate to compute its California franchise tax liability. This rate is higher than the California non-financial corporation income tax rate because the financial corporation income tax rate reflects an amount "in lieu" of local personal property and business license taxes that are paid by non-financial corporations, but not by banks or other financial corporations. The financial corporation income tax rate was 10.84% for both 2000 and 1999.

The Bank files a California franchise tax return on a combined reporting basis. Other state income and franchise tax returns are filed on a separate-entity basis in Arizona, Colorado, Idaho, Oregon and Utah. The Bank anticipates that additional state income and franchise tax returns will be required in future years as its lending business is expanded nationwide.

The Internal Revenue Service and state taxing authorities have examined our tax returns for all tax years through 1995 and are currently reviewing returns filed for the 1996 tax year. The Bank made a payment of $10.7 million during 2000 to settle federal tax claims related to the sale and leaseback of computer equipment in 1990. This amount had been previously reflected in the Bank's tax accrual, and therefore had no adverse impact upon current year earnings. In addition, the Bank's management believes it has adequately provided for potential exposure with regard to other issues in the years currently under examination. Our tax years subsequent to 1996 remain open to review by federal and state tax authorities.

FACTORS THAT MAY AFFECT FUTURE RESULTS

The following discusses certain factors which may affect our financial results and operations and should be considered in evaluating Downey.

Economic Conditions and Geographic Concentrations. Downey is headquartered in and its operations are concentrated in California. As a result of this geographic concentration, our results depend largely upon economic conditions in the state. Leading business forecasters and economists predict that economic growth may slow substantially from 2000. A significant contributor to the projected 2001 slowdown is California's current energy crisis. The expected hike in energy rates could impede growth by reducing business investment and consumer spending within the state. Other issues facing the state's economy are potential job losses as California "dot.com" companies continue to reduce their workforce. A deterioration in economic conditions could have a material adverse impact on the quality of our loan and real estate portfolios and the demand for our products and services.

Interest Rates. We anticipate that short-term interest rate levels will likely decline in 2001, and if interest rates vary substantially from present levels, our results may differ materially from current levels. Changes in interest rates will influence the growth of loans, investments and deposits and affect the rates received on loans and investment securities and paid on deposits. Changes in interest rates also affect the value of our recorded

mortgage servicing rights on loans we service for others, generally increasing in value as interest rates rise and declining as interest rates fall. If interest rates were to increase significantly, the economic feasibility of real estate investment activities also could be adversely affected.

Government Regulation and Monetary Policy. The financial services industry is subject to extensive federal and state supervision and regulation. Significant new laws or changes in, or repeals of, existing laws may cause our

results to differ materially. Further, federal monetary policy, particularly as implemented through the Federal Reserve System, significantly affects credit conditions for Downey, primarily through open market operations in United States government securities, the discount rate for borrowings and reserve requirements, and a material change in these conditions would be likely to have a material impact on our results.

Competition. The banking and financial services business in our market areas is highly competitive. The increasingly competitive environment is a result primarily of changes in regulation, changes in technology and product delivery systems, and the accelerating pace of consolidation among financial services providers. Our results may differ if circumstances affecting the nature or level of competition change.

Credit Quality. A significant source of risk arises from the possibility that losses will be sustained because borrowers, guarantors and related parties may fail to perform in accordance with the terms of their loans. We have adopted prudent underwriting and loan quality monitoring systems, procedures and credit policies, including the establishment and review of the allowance for loan losses, that management believes are appropriate to minimize this risk by tracking loan performance, assessing the likelihood of nonperformance and diversifying our loan portfolio. Such policies and procedures, however, may not prevent unexpected losses that could materially adversely affect our results.

ITEM 2. PROPERTIES

BRANCHES

The corporate offices of Downey, the Bank and DSL Service Company are located at 3501 Jamboree Road, Newport Beach, California 92660. Part of that corporate facility houses a branch office of the Bank. Certain departments (warehousing, record retention, etc.) are located in other owned and leased facilities in Orange County, California. The majority of our administrative operations, however, are located in our corporate headquarters.

At December 31, 2000, we had 114 branches. We owned the building and land occupied by 56 of our branches and we owned one branch building on leased land. We operate branches in 57 locations (including 49 in-store locations) with leases or licenses expiring at various dates through October 2010, with options to extend the term.

The net book value of our owned branches, including the one on leased land, totaled $82 million at December 31, 2000 and the net book value of our leased branch offices totaled $2 million at December 31, 2000. The net book value of our furniture and fixtures, including electronic data processing equipment, was $20 million at December 31, 2000.

For additional information regarding our offices and equipment, see Note 1 on page 69 and Note 9 on page 85 of Notes to Consolidated Financial Statements.

ELECTRONIC DATA PROCESSING

We utilize a mainframe computer system with use of various third-party vendors' software for retail deposit operations, loan servicing, accounting and loan origination functions, including our operations conducted over the Internet. The net book value of our electronic data processing equipment, including personal computers and software, was $12 million at December 31, 2000.

ITEM 3. LEGAL PROCEEDINGS

We have been named as a defendant in legal actions arising in the ordinary course of business, none of which, in the opinion of management, is material.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SHAREHOLDERS

No matters were submitted to shareholders during the fourth quarter of 2000.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock is traded on the New York Stock Exchange ("NYSE") and the Pacific Exchange ("PCX") with the trading symbol "DSL." At February 28, 2001, we had approximately 873 stockholders of record (not including the number of persons or entities holding stock in nominee or street name through various brokerage firms) and 28,211,048 outstanding shares of common stock.

The following table sets forth for the quarters indicated the range of high and low sale prices per share of our common stock as reported on the NYSE Composite Tape.

	2000				1999			
	4th Quarter	3rd Quarter	2nd Quarter	1st Quarter	4th Quarter	3rd Quarter	2nd Quarter	1st Quarter
High	$60.88	$40.94	$33.00	$21.44	$22.94	$24.13	$23.00	$25.75
Low	33.13	29.94	20.44	18.75	19.06	19.81	18.13	18.25
End of period	55.00	39.50	28.98	21.25	20.19	20.13	21.94	18.31

During 2000, we paid quarterly cash dividends totaling $0.36 per share, aggregating $10.1 million compared to $0.35 per share, aggregating $9.9 million during 1999. On February 23, 2001, we paid a $0.09 per share quarterly cash dividend, aggregating $2.5 million.

We may pay additional dividends out of funds legally available therefor at such times as the Board of Directors determines that dividend payments are appropriate. The Board of Directors' policy is to consider the declaration of dividends on a quarterly basis.

The payment of dividends by the Bank to Downey is subject to OTS regulations. For further information regarding these regulations see Business--Regulation--Regulation of the Bank--Capital Distribution Limitations on page 16.

ITEM 6. SELECTED FINANCIAL DATA

(Dollars in Thousands, Except Per Share Amounts)	2000	1999	
INCOME STATEMENT DATA:			
Total interest income	$ 784,360	$ 533,751	$ 4
Total interest expense	521,885	326,273	2
Net interest income	262,475	207,478	1
Provision for loan losses	3,251	11,270	
Net interest income after provision for loan losses	259,224	196,208	1
Other income, net:			
Loan and deposit related fees	30,089	20,097	
Real estate and joint ventures held for investment, net	8,798	19,302	
Secondary marketing activities:			
Loan servicing fees	(3,628)	1,672	
Net gains on sales of loans and mortgage-backed securities	3,297	14,806	
Net gains (losses) on sales of investment securities	(106)	288	
Gain on sale of subsidiary (1)	9,762	--	
Other	2,342	3,113	
Total other income, net	50,554	59,278	
Operating expense:			
General and administrative expense	136,189	144,382	1
SAIF special assessment (2)	--	--	
Net operation of real estate acquired in settlement of loans	818	19	
Amortization of excess of cost over fair value of net assets acquired	462	474	
Total operating expense	137,469	144,875	1
Net income (1) (2)	$ 99,251	$ 63,804	$
PER SHARE DATA:			
Earnings per share--Basic (1) (2)	$ 3.52	$ 2.27	$
Earnings per share--Diluted (1) (2)	3.51	2.26	
Book value per share at end of period	22.15	18.91	
Stock price at end of period	55.00	20.19	
Cash dividends paid	0.36	0.35	
SELECTED FINANCIAL RATIOS:			
Effective interest rate spread	2.66%	2.88%	
Return on average assets (1) (2)	0.97	0.85	
Return on average equity (1) (2)	17.17	12.70	
Dividend payout ratio	10.22	15.44	
LOAN ACTIVITY:			
Loans originated	$ 5,218,368	$7,132,486	$4,0
Loans and mortgage-backed securities purchased	18,828	49,669	
Loans and mortgage-backed securities sold	1,662,600	2,386,958	1,7
BALANCE SHEET SUMMARY (END OF PERIOD):			
Total assets	$10,893,863	$9,407,540	$6,2
Loans and mortgage-backed securities	10,084,353	8,746,063	5,7
Investments and cash equivalents	439,968	299,698	2
Deposits	8,082,689	6,562,761	5,0
Borrowings	1,978,572	2,122,780	7
Capital securities	120,000	120,000	

Stockholders' equity	624,636	532,418	4
Loans serviced for others	3,964,462	2,923,778	1,0
AVERAGE BALANCE SHEET DATA:			
Assets	$10,217,371	$7,501,228	$5,9
Loans	9,514,978	6,937,342	5,3
Deposits	7,290,850	5,697,292	5,1
Stockholders' equity	577,979	502,412	4

ITEM 6. SELECTED FINANCIAL DATA (CONTINUED)

(Dollars in Thousands, Except Per Share Amounts)	2000	1999	
CAPITAL RATIOS:			
Average stockholders' equity to average assets	5.66%	6.70%	
Bank only--end of period (3):			
Core and tangible capital	6.42	6.27	
Risk-based capital	12.94	12.14	
SELECTED ASSET QUALITY DATA (END OF PERIOD):			
Total non-performing assets	$ 54,974	$ 39,194	$ 2
Non-performing assets as a percentage of total assets	0.50%	0.42%	
Allowance for loan losses:			
Amount	$ 34,452	$ 38,342	$ 3
As a percentage of non-performing loans	76.63%	116.25%	1

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Certain statements under this caption constitute "forward-looking statements" under the Private Securities Litigation Reform Act of 1995 which involve risks and uncertainties. Our actual results may differ significantly from the results discussed in such forward-looking statements. Factors that might cause such a difference include, but are not limited to, economic conditions, competition in the geographic and business areas in which we conduct our operations, fluctuations in interest rates, credit quality and government regulation. For additional information concerning these factors, see Business--Factors that May Affect Future Results on page 20.

OVERVIEW

Our net income for 2000 totaled a record $99.2 million or $3.51 per share on a diluted basis. Included in the results was a $5.6 million after-tax gain from the sale of our indirect automobile finance subsidiary in February 2000. Excluding the gain, our net income for the year would have been $93.6 million or $3.32 per share on a diluted basis, up 46.8% from $63.8 million or $2.26 per

share in 1999.

The increase in our adjusted net income between years was due to higher net income from our banking operations, as net income from our real estate investment activities declined $5.6 million to $4.4 million due primarily to lower net gains from sales of properties. On an adjusted basis, net income from our banking operations increased $35.4 million or 65.8% to $89.2 million due to the following:

- net interest income increased $54.4 million or 26.2% due to an increase in average interest-earning assets as our effective interest rate spread declined;

- provision for loan losses declined by $8.0 million due primarily to lower growth in our loan portfolio than a year ago and the sale of our indirect automobile finance subsidiary; and

- operating expense declined by $7.1 million due to lower general and administrative costs primarily associated with residential lending activities and the sale of our indirect automobile finance subsidiary. Our efficiency ratio (the percentage of our net interest income and other income excluding income from real estate investment activities and investment securities gains or losses used to cover our general and administrative costs) improved from 58.4% in 1999 to 46.2% in 2000.

Those favorable items were partially offset by a $8.1 million decline in other income, as an increase of $10.0 million in loan and deposit related fees were unable to offset the following:

- a $11.5 million decline in net gains on sales of loans and mortgage-backed securities due to a lower volume of loans being sold; and

- a $3.6 million loss in loan servicing fees compared to income of $1.7 million in 1999. Our current year loss resulted from a $6.1 million addition to the valuation allowance for mortgage servicing rights due to an increase in expected prepayments from the drop in late 2000 in mortgage interest rates.

For 2000, our return on average assets was 0.97% and our return on average equity was 17.17%. Excluding the gain on sale of subsidiary, our adjusted returns were 0.92% on average assets and 16.20% on average equity. Both these performance ratios compare favorably to 1999 when our return on average assets was 0.85% and our return on average equity was 12.70%.

Our assets increased $1.5 billion or 15.8% during 2000 to $10.9 billion at year-end, following a record 50.0% increase during 1999. Assets expanded in 2000 primarily from loan growth. Our single family loan originations decreased from $6.7 billion in 1999 to $5.0 billion in 2000, of which $1.7 billion were originated for sale in the secondary market. Of the current year's total, $405 million represented originations for portfolio of subprime credits as part of our continuing strategy to enhance the portfolio's net yield. In addition to single family loans, we originated $254 million of other loans during the year, including $115 million of construction and land loans and $57 million of automobile loans.

We funded our asset growth with deposits that increased 23.2% to $8.1 billion at December 31, 2000.

Non-performing assets totaled $55 million at December 31, 2000, up from $39 million a year ago. This increase was due primarily to a rise in residential

non-performers, of which $11 million was in the subprime

category. When measured as a percentage of total assets, our non-performing assets rose from 0.42% at year-end 1999 to 0.50% at year-end 2000.

At December 31, 2000, the Bank exceeded all three regulatory capital tests, with capital-to-asset ratios of 6.42% in tangible and core capital and 12.94% in risk-based capital. These capital levels are significantly above the "well capitalized" standards defined by the federal banking regulators of 5% for core and tangible capital and 10% for risk-based capital. For further information, see Business--Regulation--Regulation of the Bank--Insurance of Deposit Accounts on page 12, Financial Condition--Investments in Real Estate and Joint Ventures on page 39 and Financial Condition--Regulatory Capital Compliance on page 58.

RESULTS OF OPERATIONS

NET INTEREST INCOME

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

Our net interest income was $262.5 million in 2000, up $55.0 million or 26.5% from 1999 and $88.1 million or 50.5% greater than 1998. The 2000 improvement over 1999 primarily reflected an increase in average earning assets as our effective interest rate spread declined. Our average earning assets increased by $2.7 billion or 37.3% to $9.9 billion. Our effective interest rate spread averaged 2.66% in 2000, down from 2.88% in 1999 and 3.08% in 1998. The decline in the effective interest rate spread primarily reflected a higher proportion of earning assets in the current year being funded with higher cost certificates of deposit and borrowings thereby resulting in the cost of funds increasing more rapidly than the yield on earning assets. To a lesser extent, the sale of our indirect automobile lending subsidiary also contributed to the decline in the effective interest rate spread, as the loan yield on that portfolio was higher than the yield on our remaining loan portfolio.

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

- interest income from average interest-earning assets and the resultant yields; and

- interest expense on average interest-bearing liabilities and the resultant costs, expressed as rates.

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

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

- average interest-earning assets for the period.

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

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(Dollars in Thousands)	2000 Average Balance	2000 Interest	2000 Average Yield/ Rate	1999 Average Balance	1999 Interest	1999 Avera Yiel Rat
Interest-earning assets:						
Loans	$ 9,514,978	$760,538	7.99%	$6,937,342	$519,006	7.4
Mortgage-backed securities	15,959	1,060	6.64	26,361	1,638	6.2
Investment securities	346,192	22,762	6.57	232,746	13,107	5.6
Total interest-earning assets	9,877,129	784,360	7.94	7,196,449	533,751	7.4
Non-interest-earning assets	340,242			304,779		
Total assets	$10,217,371			$7,501,228		
Transaction accounts:						
Non-interest-bearing checking	$ 209,221	$ --	-- %	$ 165,271	$ --	--
Interest-bearing checking (1)	381,269	3,520	0.92	336,604	3,517	1.0
Money market	89,495	2,544	2.84	95,282	2,641	2.7
Regular passbook	796,212	27,841	3.50	767,238	26,224	3.4
Total transaction accounts	1,476,197	33,905	2.30	1,364,395	32,382	2.3
Certificates of deposit	5,814,653	345,398	5.94	4,332,897	224,382	5.1
Total deposits	7,290,850	379,303	5.20	5,697,292	256,764	4.5
Borrowings	2,118,497	130,419	6.16	1,175,704	64,161	5.4
Capital securities	120,000	12,163	10.14	52,903	5,348	10.1
Total deposits, borrowings and capital securities	9,529,347	521,885	5.48	6,925,899	326,273	4.7
Other liabilities	110,045			72,917		
Stockholders' equity	577,979			502,412		
Total liabilities and stockholders' equity	$10,217,371			$7,501,228		
Net interest income/interest rate spread		$262,475	2.46%		$207,478	2.7
Excess of interest-earning assets over						

deposits, borrowings and capital securities	$ 347,782	$ 270,550	
Effective interest rate spread	2.66		2.8

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

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

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

	2000 Versus 1999 Changes Due To				19 C	
(In Thousands)	Volume	Rate	Rate/ Volume	Net	Volume	Ra
Interest income:						
Loans	$192,842	$35,500	$13,190	$241,532	$125,663	$(22
Mortgage-backed securities	(646)	113	(45)	(578)	(1,038)	
Investment securities	6,389	2,196	1,070	9,655	(2,465)	
Change in interest income	198,585	37,809	14,215	250,609	122,160	(22
Interest expense:						
Transaction accounts:						
Interest-bearing checking (1) .	466	(409)	(54)	3	476	
Money market	(161)	68	(4)	(97)	14	
Regular passbook	990	604	23	1,617	7,586	1
Total transaction accounts ..	1,295	263	(35)	1,523	8,076	
Certificates of deposit	76,733	32,998	11,285	121,016	20,897	(19
Total interest-bearing deposits	78,028	33,261	11,250	122,539	28,973	(18
Borrowings	51,433	8,927	5,898	66,258	53,612	(1
Capital securities	6,815	--	--	6,815	--	
Change in interest expense	136,276	42,188	17,148	195,612	82,585	(20

Change in net interest income	$ 62,309	$(4,379)	$(2,933)	$ 54,997	$ 39,575	$ (2

PROVISION FOR LOAN LOSSES

Provision for loan losses was $3.3 million in 2000, down from $11.3 million in 1999 and $3.9 million in 1998. The decrease in our provision for loan losses in 2000 is due primarily to lower growth in our loan portfolio than a year ago and the previously mentioned sale of the indirect automobile finance subsidiary.

For further information, see Financial Condition--Problem Loans and Real Estate--Allowance for Losses on Loans and Real Estate on page 52.

OTHER INCOME

Our total other income was $50.6 million in 2000, down from $59.3 million in 1999 but up from $47.4 million in 1998. Other income in 2000 included a $9.8 million pre-tax gain associated with our sale of the indirect automobile finance subsidiary. Excluding that gain, our other income declined by $18.5 million in 2000 primarily due to:

- a $11.5 million decline in net gains on sales of loans and mortgage-backed securities;
- a $10.5 million decline in income from real estate investment activities; and
- a $3.6 million loss in loan servicing fees compared to income of $1.7 million in 1999.

Those declines were partially offset by a $10.0 million increase in our loan and deposit related fees. Below is a further discussion of the major other income categories.

LOAN AND DEPOSIT RELATED FEES

Loan and deposit related fees totaled $30.1 million in 2000, up from $20.1 million in 1999 and $15.6 million in 1998. Our loan related fees increased by $6.1 million or 57.9% in 2000 due primarily to higher prepayment fees, while our deposit related fees increased by $3.9 million or 40.6% due primarily to a $2.6 million increase in fees from automated teller machines.

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

(In Thousands)	2000	1999	1998
Loan related fees	$16,722	$10,589	$ 7,225
Deposit related fees	13,367	9,508	8,420
Total loan and deposit related fees	$30,089	$20,097	$15,645

REAL ESTATE AND JOINT VENTURES HELD FOR INVESTMENT

Income from our real estate and joint ventures held for investment totaled $8.8 million in 2000, down from $19.3 million in 1999 and $22.4 million in 1998.

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

(In Thousands)	2000	1999	1998
Operations, net:			
Rental operations, net of expenses	$2,572	$ 3,822	$ 3,723
Equity in net income from joint ventures	3,224	5,352	9,203
Interest from joint venture advances	887	1,256	1,584
Total operations, net	6,683	10,430	14,510
Net gains on sales of wholly owned real estate	2,981	5,206	2,557
Reduction of (provision for) losses on real estate and joint ventures	(866)	3,666	5,296
Income from real estate and joint ventures held for investment	$8,798	$19,302	$22,363

Our income from real estate held for investment decreased by $10.5 million due to several factors. First, our net gains from sales declined by $4.5 million to $6.1 million. Of the decline, $2.3 million was related to joint venture projects reported in the category equity in net income from joint ventures. Second, we provided $0.9 million in 2000 to our allowance for losses on real estate and joint ventures, while in 1999 our allowance was reduced by $3.7 million. Finally, net rental income declined by $1.3 million due to fewer properties owned.

For additional information, see Financial Condition--Investments in Real Estate and Joint Ventures on page 39, Financial Condition--Problem Loans and Real Estate--Allowance for Losses on Loans and Real Estate on page 52 and Note 7 of Notes to Consolidated Financial Statements on page 80.

SECONDARY MARKETING ACTIVITIES

Sales of loans and mortgage-backed securities we originated decreased in 2000 to $1.7 billion from $2.4 billion in 1999 but were the same as in 1998. Net gains associated with these sales totaled $3.3 million in 2000, down from $14.8 million in 1999 and $6.5 million in 1998. The net gains included $18.5 million in 2000, $29.3 million in 1999 and $7.3 million in 1998 related to the capitalization of mortgage servicing rights.

A loss of $3.6 million was recorded in loan servicing fees from our portfolio of loans serviced for others during 2000, compared to income of $1.7 million in 1999 and $0.3 million in 1998. The loss in 2000 reflects an increase of $6.1 million in the valuation allowance for mortgage servicing rights due to an increase in expected prepayments from the drop in mortgage interest rates in late 2000. At December 31, 2000, we serviced $4.0 billion of loans for others, compared to $2.9 billion at December 31, 1999 and $1.0 billion at December 31, 1998.

For additional information concerning mortgage servicing rights, see Note 11 of Notes to Consolidated Financial Statements on page 86.

OTHER CATEGORY

The all other category of other income totaled $2.3 million in 2000, down from $3.1 million in 1999 and $2.6 million in 1998.

OPERATING EXPENSES

Our operating expenses totaled $137.5 million in 2000, down from $144.9 million in 1999 and up from $116.7 million in 1998. The current year decrease was due to lower general and administrative expense, which declined by $8.2 million or 5.7%. That decline was primarily due to lower costs associated with our residential lending activities and the sale of our indirect automobile finance subsidiary.

The following table presents a breakdown of key components comprising operating expense during the periods indicated.

(In Thousands)	2000	1999	1998
Salaries and related costs	$ 82,522	$ 86,163	$ 66,1
Premises and equipment costs	23,220	20,617	16,8
Advertising expense	4,786	8,595	5,9
Professional fees	3,319	2,502	2,8
SAIF insurance premiums and regulatory assessments	2,626	3,937	3,8
Other general and administrative expense	19,716	22,568	20,2
Total general and administrative expense	136,189	144,382	115,8
Net operation of real estate acquired in settlement of loans	818	19	2
Amortization of excess of cost over fair value of net assets acquired	462	474	5
Total operating expense	$137,469	$144,875	$116,6

PROVISION FOR INCOME TAXES

Our effective tax rate for 2000 was 42.4%, compared to 42.3% in 1999 and 42.7% in 1998. See Note 1 on page 69 and Note 18 on page 91 of Notes to Consolidated Financial Statements for a further discussion of income taxes and an explanation of the factors which impact Downey's effective tax rate.

BUSINESS SEGMENT REPORTING

The previous sections of the Results of Operations discussed our consolidated results. The purpose of this section is to present data on the results of operations of our two business segments--banking and real estate investment. For a description of these business segments and the accounting policies used, see Business on page 1 and Note 1 on page 69 and Note 26 on page 102 of Notes to Consolidated Financial Statements.

The following table presents by business segment our net income for 2000,

1999 and 1998, followed by a discussion of the results of operations of each segment.

(In Thousands)	2000 (1)	1999	1998 (2)
Banking net income	$94,822	$53,796	$46,736
Real estate investment net income	4,429	10,008	11,237
Total net income	$99,251	$63,804	$57,973

BANKING

Net income from our banking operations totaled $94.8 million in 2000, up from $53.8 million in 1999 and $46.7 million in 1998. The previously mentioned sale of our indirect automobile finance subsidiary benefited our net income from banking operations by $5.6 million. Excluding the gain, our net income from banking operations would have increased during 2000 by $35.4 million or 65.8%.

The increase in our adjusted 2000 net income reflected several factors. Net interest income increased $54.4 million or 26.2% due to an increase in our average earning assets as our effective interest rate spread declined. Also contributing to the increase between years were decreases of $8.0 million in provision for loan losses and $7.1 million in operating expense. These decreases were primarily associated with the sale of our indirect automobile finance subsidiary as well as lower loan origination volumes and costs associated with residential lending activities. These favorable items were partially offset by a decline of $8.1 million in adjusted other income. The decline in adjusted other income was primarily due to lower net gains/losses on sales of loans and mortgage-backed securities and loan servicing fees which more than offset higher loan and deposit related fees.

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

(In Thousands)	2000 (1)	1999	1998
Net interest income	$ 262,232	$ 207,784	$ 174,967
Provision for loan losses	3,251	11,270	3,918
Other income:			
Gain on sale of subsidiary	9,762	--	--
All other	31,644	39,755	24,617
Operating expense	135,996	143,081	113,954
Net intercompany income (expense)	397	393	(107)
Income before income taxes	164,788	93,581	81,605
Income taxes	69,966	39,785	34,869
Net income	$ 94,822	$ 53,796	$ 46,736
AT DECEMBER 31:			
Assets:			
Loans and mortgage-backed securities	$10,084,353	$8,746,063	$5,788,365
Other	806,201	654,745	464,097

Total assets	10,890,554	9,400,808	6,252,462
Equity	$ 624,636	$ 532,418	$ 480,566

REAL ESTATE INVESTMENT

Net income from our real estate investment operations totaled $4.4 million in 2000, down from $10.0 million in 1999 and $11.2 million in 1998. The decline was primarily attributed to lower net gains on sales and to an increase to valuation allowances in the current year compared to a reduction in valuation allowances in 1999. Also contributing to the decline was a lower level of net rental income due to fewer properties being owned.

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

(In Thousands)	2000	1999	1998
Net interest income (expense)	$ 243	$ (306)	$ (620)
Reduction of loan losses	--	--	(19)
Other income	9,148	19,523	22,736
Operating expense	1,473	1,794	2,706
Net intercompany income (expense)	(397)	(393)	107
Income before income taxes	7,521	17,030	19,536
Income taxes	3,092	7,022	8,299
Net income	$ 4,429	$10,008	$11,237
AT DECEMBER 31:			
Assets:			
Investments in real estate and joint ventures	$17,641	$42,172	$49,447
Other	3,584	7,399	9,841
Total assets	21,225	49,571	59,288
Equity	$17,916	$42,839	$41,331

For a further discussion regarding income from real estate investment, see Other Income--Real Estate and Joint Ventures Held For Investment on page 31, and for information regarding related assets, see Financial Condition--Investments in Real Estate and Joint Ventures on page 39.

FINANCIAL CONDITION

LOANS AND MORTGAGE-BACKED SECURITIES

Loans and mortgage-backed securities, including those we hold for sale, totaled $10.1 billion or 92.6% of assets at December 31, 2000. This represents an increase of $1.3 billion or 15.3% from year-end 1999. The increase represents a higher level of loans held for investment, primarily one-to-four unit residential loans.

Our loan originations, including loans purchased, totaled $5.2 billion in 2000, down from $7.2 billion in 1999 but up from $4.1 billion in 1998. This current year decrease primarily reflects a decline in originations of one-to-four unit residential loans. Of the $5.0 billion of one-to-four unit residential loans we originated, approximately 65% or $3.3 billion were for portfolio, while the balance was originated for sale in the secondary market. Our origination of subprime loans totaled $492 million in 2000, down from $1.2 billion in 1999.

The table below presents information regarding interest rates and fees collected on loans originated during the periods indicated.

(Dollars in Thousands)	2000	1999	1998	19
Average interest rate on new loans	6.10%	5.92%	6.45%	6
Total loan origination costs (net of fees) and premiums (net of discounts) deferred during the year	$34,797	$53,181	$30,621	$11,

We originate one-to-four unit residential adjustable rate mortgages both with and without loan origination fees. In adjustable rate mortgage transactions for which we charge no origination fees, we receive a larger margin over the index to which the loan pricing is tied than in those in which we charge fees. In addition, a prepayment fee on these loans is generally required if prepaid within the first three years. This trend towards loans with no origination fees has generally resulted in deferrable loan origination costs exceeding loan origination fees.

Residential one-to-four unit adjustable rate mortgage originations, including loans purchased, were $3.5 billion during 2000, down from $4.4 billion in 1999 but up from $1.4 billion in 1998. Refinancing activities related to residential one-to-four unit loans, including new loans to refinance existing loans which we or other lenders originated, constituted 42% of originations during the year compared to 63% during 1999 and 71% during 1998. Refinancing activities decreased from $4.2 billion in 1999 to $2.1 billion in 2000 as a higher interest rate environment existed throughout most of the year. In addition, the majority of residential originations were adjustable rate mortgages tied to the FHLB Eleventh District Cost of Funds Index ("COFI"), an index which lags the movement in market interest rates. For the year, 86% of one-to-four unit originations for investment represented monthly adjusting COFI rate mortgages which provide for negative amortization, 11% represented COFI rate mortgages which reprice every six months but do not provide for negative amortization, with the balance represented by a variety of other pricing terms. At December 31, 2000, $6.9 billion of our one-to-four unit adjustable rate mortgages were subject to negative amortization of which $148 million represented the amount of negative amortization added to the unpaid loan balance. For further information, see Business--Banking Activities--Lending Activities--Residential Real Estate Lending on page 3.

Our origination of commercial real estate loans, including loans purchased,

totaled $24 million in 2000, compared to $10 million in 1999 and $11 million in 1998. Originations of loans secured by multi-family properties, including loans purchased, totaled $1 million in both 2000 and 1999, compared to $15 million in 1998.

During 2000, we originated $99 million of construction loans, principally for entry level and first time move-up residential tracts. This compares to $149 million in 1999 and $112 million in 1998. Our origination of land development loans totaled $17 million in 2000, compared to $57 million in 1999 and $48 million in 1998.

Origination of non-mortgage commercial loans decreased to $19 million in 2000 from $25 million in 1999 but were up from $6 million in 1998. A substantial majority of these originations represented secured loans.

Origination of automobile loans totaled $57 million in 2000, compared to $234 million in 1999 and $175 million in 1998. Prior to 2000, the majority of these originations represented our indirect lending program that was conducted by Downey Auto Finance Corp., a former subsidiary, whereby loans to finance the purchase of new or used automobiles were obtained through preapproved automobile dealers. For further information regarding Downey Auto Finance Corp., see Sale of Subsidiary on page 61.

At December 31, 2000, we had commitments to fund loans amounting to $694 million, of which $239 million were one-to-four unit residential loans being originated for sale in the secondary market, as well as undrawn lines of credit of $81 million and loans in process of $67 million. We believe our current sources of funds will enable us to meet these obligations while exceeding all regulatory liquidity requirements.

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

(In Thousands)	2000	1999	1998
INVESTMENT PORTFOLIO:			
Loans originated:			
Loans secured by real estate:			
Residential one-to-four units:			
Adjustable	$ 2,831,596	$ 3,102,810	$ 943,736
Adjustable - subprime	395,911	1,182,552	372,286
Total adjustable	3,227,507	4,285,362	1,316,022
Fixed	9,167	262,923	192,436
Fixed - subprime	--	12,238	6,020
Residential five or more units:			
Adjustable	--	247	875
Fixed	678	--	13,229
Total residential	3,237,352	4,560,770	1,528,582
Commercial real estate	23,720	10,063	10,363
Construction	98,330	149,143	111,534
Land	16,530	56,851	48,357
Non-mortgage:			

Commercial	18,504	24,948	6,376
Automobile	56,576	233,948	175,193
Other consumer	38,136	54,489	28,274
Total loans originated	3,489,148	5,090,212	1,908,679
Real estate loans purchased:			
One-to-four units	9,178	36,317	4,343
One-to-four units - subprime	8,595	12,912	1,833
Other (1)	1,055	440	1,287
Total real estate loans purchased	18,828	49,669	7,463
Total loans originated and purchased	3,507,976	5,139,881	1,916,142
Loan repayments	(1,981,802)	(1,823,585)	(1,855,157
Other net changes (2)	(291,935)	(36,794)	(34,145
Net increase in loans held for investment	1,234,239	3,279,502	26,840
SALE PORTFOLIO:			
Residential, one-to-four units:			
Originated whole loans	1,642,046	2,028,402	2,162,583
Originated whole loans - subprime	87,174	13,872	--
Loans transferred from (to) the investment portfolio	54,993	42,570	(3,056
Originated whole loans sold	(687,512)	(999,594)	(1,130,303
Loans exchanged for mortgage-backed securities	(970,319)	(1,387,364)	(608,831
Other net changes	(10,815)	(9,263)	(8,111
Net increase (decrease) in loans held for sale	115,567	(311,377)	412,282
Mortgage-backed securities, net:			
Received in exchange for loans	970,319	1,387,364	608,831
Purchased	--	--	--
Sold	(975,088)	(1,387,364)	(610,113
Repayments	(7,031)	(9,936)	(15,129
Other net changes	284	(491)	(742
Net increase (decrease) in mortgage-backed securities available for sale	(11,516)	(10,427)	(17,153
Net increase (decrease) in loans held for sale and mortgage-backed securities available for sale	104,051	(321,804)	395,129
Total net increase in loans and mortgage-backed securities	$ 1,338,290	$ 2,957,698	$ 421,969

The following table sets forth the composition of our loan and mortgage-backed securities portfolio at the dates indicated. At December 31, 2000, approximately 93% of our real estate loans were secured by real estate located in California, principally in Los Angeles, Orange, Santa Clara, San Diego and San Mateo counties.

December 31,

(In Thousands)	2000	1999	1998	
INVESTMENT PORTFOLIO:				
Loans secured by real estate:				
Residential one-to-four units:				
Adjustable	$ 7,200,400	$5,644,883	$3,721,728	$
Adjustable - subprime	1,726,526	1,620,624	580,232	
Fixed	454,838	510,516	325,454	
Fixed - subprime	17,388	18,777	8,719	
Total one-to-four units	9,399,152	7,794,800	4,636,133	
Residential five or more units:				
Adjustable	14,203	15,889	18,617	
Fixed	5,257	5,166	21,412	
Commercial real estate:				
Adjustable	37,374	37,419	39,360	
Fixed	127,230	110,908	101,430	
Construction	118,165	176,487	127,761	
Land	26,880	67,631	44,859	
Non-mortgage:				
Commercial	21,721	26,667	28,293	
Automobile (1)	39,614	399,789	357,988	
Other consumer	60,653	49,344	41,894	
Total loans held for investment	9,850,249	8,684,100	5,417,747	
Increase (decrease) for:				
Undisbursed loan funds	(72,328)	(125,159)	(108,414)	
Net deferred costs and premiums	79,109	67,740	31,021	
Allowance for losses	(34,452)	(38,342)	(31,517)	
Total loans held for investment, net	9,822,578	8,588,339	5,308,837	
SALE PORTFOLIO, NET:				
Loans held for sale:				
One-to-four units	251,014	122,133	447,382	
One-to-four units - subprime	558	13,872	--	
Total loans held for sale	251,572	136,005	447,382	
Mortgage-backed securities available for sale:				
Adjustable	6,050	7,700	10,996	
Fixed	4,153	14,019	21,150	
Total mortgage-backed securities available for sale	10,203	21,719	32,146	
Total loans held for sale and mortgage-backed securities available for sale	261,775	157,724	479,528	
Total loans and mortgage-backed securities ..	$10,084,353	$8,746,063	$5,788,365	$

At December 31, 2000, our residential one-to-four units subprime portfolio consisted of approximately 71% A-, 23% B and 6% C loans. At year end, the average loan-to-value ratio at origination for these loans was approximately 75%.

We carry mortgage-backed securities available for sale at fair value which, at December 31, 2000, reflected an unrealized loss of $65,000, or $37,000 net of income taxes. The current year-end unrealized loss, less the associated tax

effect, is reflected within a separate component of other comprehensive income (loss) until realized.

The table below sets forth the scheduled contractual maturities of our loan and mortgage-backed securities portfolio at December 31, 2000.

(In Thousands)	Within 1 Year	1-2 Years	2-3 Years	3-5 Years	5-10 Years	10-15 Years	B 15
Loans secured by real estate:							
Residential:							
One-to-four units:							
Adjustable (1)	$ 61,539	$ 66,956	$ 72,850	$165,506	$559,374	$852,933	$7,1
Fixed (1)	7,751	8,399	9,103	20,548	68,432	102,251	5
Five or more units:							
Adjustable	279	304	330	746	2,502	3,771	
Fixed	206	221	237	525	1,672	2,350	
Commercial real estate:							
Adjustable	2,185	2,402	2,639	6,086	21,324	2,738	
Fixed	13,044	14,203	15,464	35,167	49,352	--	
Construction - adjustable	118,165	--	--	--	--	--	
Land:							
Adjustable	20,520	5,474	--	--	--	--	
Fixed	70	77	84	193	462	--	
Non-mortgage:							
Commercial	20,188	892	641	--	--	--	
Automobile	9,264	10,158	11,138	9,054	--	--	
Other consumer (2)	4,148	4,587	5,074	4,156	42,688	--	
Total loans	257,359	113,673	117,560	241,981	745,806	964,043	7,6
Mortgage-backed securities, net	4,262	118	127	286	939	1,379	
Total loans and mortgage-backed securities	$261,621	$113,791	$117,687	$242,267	$746,745	$965,422	$7,6

At December 31, 2000, the maximum amount the Bank could have loaned to any one borrower, and related entities, under regulatory limits was $112 million, or $187 million for loans secured by readily marketable collateral, compared to $100 million or $167 million for loans secured by readily marketable collateral at year-end 1999. We do not expect that these regulatory limitations will adversely impact our proposed lending activities during 2001.

INVESTMENT SECURITIES

The following table sets forth the composition of our investment securities portfolio at the dates indicated.

	December 31,			
(In Thousands)	2000	1999	1998	1997

Federal funds	$ 19,601	$ 1	$ 33,751	$ 6,095	$
U.S. Treasury and agency securities available for sale	284,102	171,823	116,061	159,398	
Corporate bonds available for sale	21,513	--	--	--	
Municipal bonds held to maturity	6,550	6,728	6,764	6,885	
Total investment securities	$331,766	$178,552	$156,576	$172,378	$

At December 31, 2000, the maturities of our investment securities and the weighted average yield of those securities were as follows.

	1 Year or Less		After 1 Year Through 5 Years		After 5 Years	
(Dollars in Thousands)	Amount	Weighted Average Yield	Amount	Weighted Average Yield	Amount	Weighted Average Yield
Federal funds	$19,601	3.36%	$ --	-- %	$ --	-- %
U.S. Treasury and agency securities	5,008	6.51	279,094	6.60	--	--
Corporate bonds available for sale	--	--	21,513	7.41	--	--
Municipal bonds (1)	--	--	--	--	6,550	5.90
Total	$24,609	4.00%	$300,607	6.66%	$6,550	5.90%

INVESTMENTS IN REAL ESTATE AND JOINT VENTURES

DSL Service Company participates as an owner of, or a partner in, a variety of real estate development projects, principally retail neighborhood shopping center developments, most of which are located in California. For additional information regarding the location of these real estate investments see Note 7 of Notes to the Consolidated Financial Statements on page 80. We have completed and substantially leased most of the real estate development projects--with a weighted average occupancy of 82% for retail neighborhood shopping centers at December 31, 2000. At December 31, 2000, the Bank had outstanding loans of $23 million to these joint ventures.

In its joint ventures, DSL Service Company is entitled to interest on its equity invested in the project on a priority basis after third-party debt and shares profits and losses with the developer partner, generally on an equal basis. DSL Service Company has obtained personal guarantees from the principals of the developer partners in a number of the joint ventures and generally requires the developer partner to secure any outstanding obligations to the joint venture, like its portion of operating losses, when the partner is unable to satisfy such obligations on a current basis. Partnership equity or deficit accounts are affected by current period results of operations, additional partner advances, partnership distributions and partnership liquidations.

As of December 31, 2000, DSL Service Company was involved with three joint

venture partners. These partners were operators of three retail neighborhood shopping centers, a commercial building, three residential housing development projects, of which two are substantially completed, and vacant land held for sale. DSL Service Company has seven wholly owned retail neighborhood shopping centers located in California and Arizona.

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The following table sets forth the condensed balance sheets of DSL Service Company's joint ventures by property type at December 31, 2000, on a historical cost basis. For one of the joint venture investments, DSL Service Company established a valuation allowance totaling $2 million as the carrying value of the associated property exceeded its fair market value. For further information regarding the establishment of loss allowances, see Problem Loans and Real Estate--Allowance for Losses on Loans and Real Estate on page 52.

(Dollars in Thousands)	Retail Neighborhood Shopping Centers	Commercial	Residential
ASSETS			
Cash	$ 190	$ 825	$1,167
Projects under development	--	--	6,879
Completed projects	15,317	5,151	--
Other assets	874	568	32
	$16,381	$6,544	$8,078
LIABILITIES AND EQUITY			
Liabilities:			
Notes payable to the Bank	$19,245	$ --	$4,153
Notes payable to others	--	4,282	--
Other	3,131	324	1,300
Equity (deficit):			
DSL Service Company (1)	(606)	930	2,174
Allowance for losses recorded by DSL Service Company (2)	1,505	--	--
Other partners' (2)	(6,894)	1,008	451
Net equity (deficit)	(5,995)	1,938	2,625
	$16,381	$6,544	$8,078
Number of joint venture projects	3	2	3

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The following table sets forth by property type our investments in real estate and related allowances for losses at December 31, 2000.

(Dollars in Thousands)	Residential	Retail Neighborhood Shopping Centers	Land	Total
Investment in wholly owned projects	$ --	$8,874 (1)	$ 6,872 (2)	$15,746
Investment in California Affordable Housing Fund	889	--	--	889
Allowance for losses	--	(430)	(1,062)	(1,492)
Net investment in real estate projects	$ 889	$8,444	$ 5,810	$15,143
Number of projects	1	7	8	16

Real estate investments entail risks similar to those our construction and commercial lending activities present. In addition, California courts have imposed warranty-like responsibility upon developers of new housing for defects in structure and the housing site, including soil conditions. This responsibility is not necessarily dependent upon a finding that the developer was negligent. Owners of real property also may incur liabilities with respect to environmental matters, including financial responsibility for clean-up of hazardous waste or other conditions, under various federal and state laws.

DEPOSITS

Our deposits increased $1.5 billion or 23.2% in 2000 and totaled $8.1 billion at December 31, 2000. Our certificates of deposit increased $1.5 billion or 30.1%, while our lower-rate transaction accounts--i.e., checking, regular passbook and money market--were virtually unchanged. Within transaction accounts, our total checking accounts (non-interest and interest bearing) increased $74 million or 13.0%. That increase, however, was essentially offset by declines in regular passbook and money market accounts, as depositors transferred funds into higher-yielding certificates of deposit. Of the total increase in our deposits, $12 million was associated with 10 new branches we opened during 2000.

The following table sets forth the amount of deposits by classification at the dates indicated.

	December 31,					
	2000		1999		1998	
(Dollars in Thousands)	Weighted Average Rate	Amount	Weighted Average Rate	Amount	Weighted Average Rate	Amo
Transaction accounts:						
Non-interest-bearing checking .	-- %	$ 244,311	-- %	$ 182,165	-- %	$ 15
Interest-bearing checking (1) .	0.78	395,640	1.00	383,973	1.00	31
Money market	2.88	89,408	2.91	95,947	2.92	9
Regular passbook	3.41	754,127	3.62	827,854	3.36	66

Total transaction accounts ..	2.12	1,483,486	2.46	1,489,939	2.30	1,23
Certificates of deposit:						
Less than 3.00%	2.41	6,357	2.47	8,717	2.62	2
3.00-3.49	3.45	25	3.02	16	3.01	
3.50-3.99	3.97	384	3.92	3,786	3.88	5
4.00-4.49	4.19	26,916	4.32	210,127	4.39	42
4.50-4.99	4.82	80,844	4.78	939,858	4.80	66
5.00-5.99	5.71	1,901,166	5.56	3,623,632	5.53	2,42
6.00-6.99	6.63	4,558,730	6.07	284,984	6.06	20
7.00 and greater	7.02	24,781	7.32	1,702	7.24	
Total certificates of deposit	6.33	6,599,203	5.39	5,072,822	5.26	3,80
Total deposits	5.56%	$8,082,689	4.72%	$6,562,761	4.53%	$5,03

The following table shows at December 31, 2000 our certificates of deposit maturities by interest rate category.

(Dollars in Thousands)	Less Than 4.00%	4.00% - 4.49%	4.50% - 4.99%	5.00% - 5.99%	6.00% - 6.99%	7.00% and Greater	Total (1
Within 3 months	$6,216	$25,706	$61,804	$ 488,051	$ 863,100	$13,602	$1,458,479
3 to 6 months	72	1,018	12,818	291,800	1,529,257	2,444	1,837,409
6 to 12 months	249	155	1,784	1,059,402	1,589,153	8,505	2,659,248
12 to 24 months	213	23	1,043	46,130	567,193	230	614,832
24 to 36 months	--	14	1,661	12,734	5,280	--	19,689
36 to 60 months	18	--	1,734	3,047	4,747	--	9,546
Over 60 months	--	--	--	--	--	--	--
Total	$6,768	$26,916	$80,844	$1,901,164	$4,558,730	$24,781	$6,599,203

BORROWINGS

At December 31, 2000, borrowings totaled $2.0 billion, down from $2.1 billion at year-end 1999 but up from $704 million at year-end 1998. The decrease in 2000 primarily occurred in advances from the FHLB.

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

	December 31,			
(Dollars in Thousands)	2000	1999	1998	199

Federal Home Loan Bank advances	$1,978,348	$2,122,407	$695,012	$352,
Other borrowings:				
Reverse repurchase agreements	--	--	--	34,
Commercial paper	--	--	--	83,
Real estate notes	224	373	8,708	12,
Total borrowings	$1,978,572	$2,122,780	$703,720	$483,
Weighted average rate on borrowings during the period	6.16%	5.46%	6.07%	6
Total borrowings as a percentage of total assets	18.16	22.56	11.22	8

The following table sets forth certain information with respect to our short-term borrowings.

(Dollars in Thousands)	2000	1999
FHLB advances with original maturities less than one year:		
Balance at end of year	$1,475,000	$1,590,500
Average balance outstanding during the year	1,601,732	616,199
Maximum amount outstanding at any month-end during the year	1,942,000	1,590,500
Weighted average interest rate during the year	6.38%	5.42
Weighted average interest rate at the end of year	6.55	5.88
Securities sold under agreement to repurchase:		
Balance at end of year	$ --	$ --
Average balance outstanding during the year	753	1,987
Maximum amount outstanding at any month-end during the year	39,250	24,875
Weighted average interest rate during the year	6.10%	5.42
Weighted average interest rate at the end of year	--	--
Commercial paper sold:		
Balance at end of year	$ --	$ --
Average balance outstanding during the year	--	--
Maximum amount outstanding at any month-end during the year	--	--
Weighted average interest rate during the year	-- %	--
Weighted average interest rate at the end of year	--	--
Total short-term borrowings:		
Total average short-term borrowings outstanding during the year	$1,602,485	$ 618,186
Total weighted average rate on short-term borrowings during the year	6.38%	5.42

At year-end 2000, total intermediate and long-term advances were $503 million, down from $532 million at December 31, 1999. The weighted average rate on our intermediate and long-term FHLB advances at year-end 2000 was 5.39%.

The following table sets forth the associated maturities at December 31, 2000.

(In Thousands)

2001	$ 16,293
2002	55,921
2003	134
2004	--
2005	1,000
Thereafter	430,000
Total intermediate and long-term FHLB advances	$503,348

CAPITAL SECURITIES

On July 23, 1999, we issued $120 million in capital securities through Downey Financial Capital Trust I. The capital securities pay quarterly cumulative cash distributions at an annual rate of 10.00% of the liquidation value of $25 per share. Interest expense, including the amortization of deferred issuance costs, on our capital securities was $12.2 million for 2000. For further information regarding our capital securities, see Note 19 on page 93 of Notes to Consolidated Financial Statements.

ASSET/LIABILITY MANAGEMENT AND MARKET RISK

Market risk is the risk of loss from adverse changes in market prices and interest rates. Our market risk arises primarily from interest rate risk in our lending and deposit taking activities. This interest rate risk occurs to the degree that our interest-bearing liabilities reprice or mature on a different basis--generally more rapidly-- than our interest-earning assets. Since our earnings depend primarily on our net interest income, which is the difference between the interest and dividends earned on interest-earning assets and the interest paid on interest-bearing liabilities, one of our principal objectives is to actively monitor and manage the effects of adverse changes in interest rates on net interest income while maintaining asset quality.

Our Asset/Liability Management Committee is responsible for implementing the interest rate risk management policy which sets forth limits established by the Board of Directors of acceptable changes in net interest income and net portfolio value from specified changes in interest rates. The OTS defines net portfolio value as the present value of expected net cash flows from existing assets minus the present value of expected net cash flows from existing liabilities plus the present value of expected cash flows from existing off-balance sheet contracts. Our Asset/Liability Management Committee reviews, among other items, economic conditions, the interest rate outlook, the demand for loans, the availability of deposits and borrowings, and our current operating results, liquidity, capital and interest rate exposure. In addition, our Asset/Liability Management Committee monitors asset and liability maturities and repricing characteristics on a regular basis and performs various simulations and other analyses to determine the potential impact of various business strategies in controlling interest rate risk and the potential impact of those strategies upon future earnings under various interest rate scenarios. Based on these reviews, our Asset/Liability Management Committee formulates a strategy that is intended to implement the objectives set forth in our business plan without exceeding the net interest income and net portfolio value limits set forth in our interest rate risk policy.

One measure of our exposure to differential changes in interest rates between assets and liabilities is shown in the following table which sets forth the repricing frequency of our major asset and liability categories as of December 31, 2000, as well as other information regarding the repricing and maturity difference between our interest-earning assets and total deposits, borrowings and capital securities in future periods. We refer to these differences as "gap." We have determined the repricing frequencies by reference

to projected maturities, based upon contractual maturities as adjusted for scheduled repayments and "repricing mechanisms"--provisions for changes in the interest and dividend rates of assets and liabilities. We assume prepayment rates on substantially all of our loan portfolio based upon our historical loan prepayment experience and anticipated future prepayments. Repricing mechanisms on a number of our assets are subject to limitations, such as caps on the amount that interest rates and payments on our loans may adjust, and accordingly, these assets do not normally respond to changes in market interest rates as completely or rapidly as our liabilities. The interest rate sensitivity of our

assets and liabilities illustrated in the following table would vary substantially if we used different assumptions or if actual experience differed from the assumptions set forth.

	December 31,			
(Dollars in Thousands)	Within 6 Months	7 - 12 Months	2 - 5 Years	6
Interest-earning assets:				
Investment securities and FHLB stock ....(1)	$ 229,409	$ 55,169	$ 153,475	$
Loans and mortgage-backed securities:				
Loans secured by real estate:				
Residential:				
Adjustable ....(2)	8,653,459	216,643	120,994	
Fixed ....(2)	287,289	29,294	173,780	1
Commercial real estate ....(2)	47,024	12,053	99,919	
Construction ....(2)	54,527	--	--	
Land ....(2)	19,652	9	67	
Non-mortgage loans:				
Commercial ....(2)	16,275	--	--	
Consumer ....(2)	68,539	7,472	23,218	
Mortgage-backed securities	10,203	--	--	
Total loans and mortgage-backed securities	9,156,968	265,471	417,978	1
Total interest-earning assets	$9,386,377	$ 320,640	$ 571,453	$ 1
Transaction accounts:				
Non-interest-bearing checking	$ 244,311	$ --	$ --	$
Interest-bearing checking ....(3)	395,640	--	--	
Money market ....(4)	89,408	--	--	
Regular passbook ....(4)	754,127	--	--	
Total transaction accounts	1,483,486	--	--	
Certificates of deposit ....(1)	3,295,888	2,659,248	644,067	
Total deposits	4,779,374	2,659,248	644,067	
Borrowings	1,484,993	6,517	57,062	4
Capital securities	--	--	--	
Total deposits, borrowings and capital securities	$6,264,367	$ 2,665,765	$ 701,129	$ 4
Excess (shortfall) of interest-earning assets over				

deposits, borrowings and capital securities ...	$3,122,010	$(2,345,125)	$(129,676)	$(3
Cumulative gap	3,122,010	776,885	647,209	3
Cumulative gap - as a % of total assets:				
December 31, 2000	28.66%	7.13%	5.94%	
December 31, 1999	21.29	10.20	4.97	
December 31, 1998	23.84	7.48	9.07	

Our six-month gap at December 31, 2000 was a positive 28.66%. This means that more interest-earning assets reprice within six months than total deposits, borrowings and capital securities. This compares to a positive six-month gap of 21.29% at December 31, 1999 and 23.84% at December 31, 1998. Our primary strategy to manage interest rate risk is to emphasize the origination of adjustable rate mortgages or loans with relatively short maturities. Interest rates on adjustable rate mortgages are primarily tied to COFI. We originated and purchased approximately $3.4 billion during 2000, $4.7 billion during 1999 and $1.5 billion during 1998 of loans and mortgage-backed securities with adjustable interest rates or maturities of five years or less. These loans represented approximately 97% during 2000, 92% during 1999 and 80% during 1998 of all loans and mortgage-backed securities originated and purchased for investment during these periods.

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At December 31, 2000, 98% of our interest-earning assets mature, reprice or are estimated to prepay within five years, compared to 97% at December 31, 1999 and 98% at December 31, 1998. At December 31, 2000, loans held for investment and mortgage-backed securities with adjustable interest rates represented 91% of those portfolios. During 2001, we will continue to offer residential fixed rate loan products to our customers to meet customer demand. We primarily originate fixed rate loans for sale in the secondary market and price them accordingly to create loan servicing income and to increase opportunities for originating adjustable rate mortgages. However, we may originate fixed rate loans for investment when funded with long-term funds to mitigate interest rate risk and small volumes to facilitate the sale of real estate acquired through foreclosure or that meet certain yield and other approved guidelines. See Business--Banking Activities--Lending Activities--Secondary Marketing and Loan Servicing Activities on page 5.

We are better protected against rising interest rates with a positive six-month gap. However, we remain subject to possible interest rate spread compression, which would adversely impact our net interest income if interest rates rise. This is primarily due to the lag in repricing of the indices to which our adjustable rate loans and mortgage-backed securities are tied, as well as the repricing frequencies and periodic interest rate caps on these adjustable rate loans and mortgage-backed securities. The amount of such interest rate spread compression would depend upon the frequency and severity of such interest rate fluctuations.

In addition to measuring interest rate risk via a gap analysis, we establish limits on, and measure the sensitivity of, our net interest income and net portfolio value to changes in interest rates. Changes in interest rates are defined as instantaneous and sustained movements in interest rates in 100 basis point increments. We utilize an internally maintained asset/liability management simulation model to make the calculations which, for net portfolio value, is calculated on a discounted cash flow basis. First, we estimate our net interest income for the next twelve months and the current net portfolio value assuming no change in interest rates from those at period end. Once the base case has

been estimated, we make calculations for each of the defined changes in interest rates, to include any associated differences in the anticipated prepayment speed of loans. We then compare those results against the base case to determine the estimated change to net interest income and net portfolio value due to the changes in interest rates. The following are the estimated impacts to net interest income and net portfolio value from various instantaneous, parallel shifts in interest rates based upon our asset and liability structure as of year-ends 2000 and 1999. Since we base these estimates upon numerous assumptions, like the expected maturities of our interest-bearing assets and liabilities and the shape of the period-end interest rate yield curve, our actual sensitivity to interest rate changes could vary significantly if actual experience differs from those assumptions used in making the calculations.

	2000		1999	
	Percentage Change in		Percentage Change in	
Change in Interest Rates (In Basis Points)	Net Interest Income(1)	Net Portfolio Value (2)	Net Interest Income (1)	Net Portfolio Value (2)
+200	(7.5)%	(3.0)%	(13.8)%	(9.7)%
+100	(3.4)	0.9	(6.8)	(1.5)
(100)	0.7	(4.8)	3.9	(2.2)
(200)	2.1	(9.9)	7.1	(4.3)

The following table shows our financial instruments that are sensitive to changes in interest rates, categorized by expected maturity, and the instruments' fair values at December 31, 2000. This data differs from that in the gap table as it does not incorporate the repricing characteristics of assets and liabilities. Rather, it only reflects contractual maturities adjusted for anticipated prepayments. Market risk sensitive instruments are generally defined as on and off balance sheet derivatives and other financial instruments.

	Expected Maturity Date at December 31,					
(Dollars in Thousands)	2001	2002	2003	2004	2005	Th
Investment securities	$ 278,097	$ 85,931	$ 24,707	$ 9,904	$ 32,933	$
Average interest rate	6.62%	6.21%	6.92%	6.66%	6.81%	
Loans held for sale	251,572	--	--	--	--	
Average interest rate	8.29%	-- %	-- %	-- %	-- %	
Mortgage-backed securities						
available for sale	5,371	942	747	596	479	
Average interest rate	6.91%	7.75%	7.74%	7.73%	7.72%	
Loans held for investment:						
Loans secured by real estate:						
Residential:						
Adjustable	2,265,459	2,448,067	1,790,709	908,947	476,854	1,

Average interest rate ..	8.42%	8.40%	8.36%	8.31%	8.23%	
Fixed	61,593	52,947	46,157	40,291	35,257	
Average interest rate ..	7.88%	7.86%	7.85%	7.83%	7.82%	
Other	81,649	64,015	27,637	28,852	8,934	
Average interest rate	9.11%	8.86%	8.79%	8.86%	8.94%	
Non-mortgage:						
Commercial	12,049	4,018	208	--	--	
Average interest rate	10.12%	10.37%	9.86%	-- %	-- %	
Consumer	16,226	11,283	7,683	64,037	--	
Average interest rate	9.95%	10.07%	10.19%	10.24%	-- %	
Interest bearing advances to joint ventures	12,339	--	--	--	--	
Average interest rate	4.32%	-- %	-- %	-- %	-- %	
MSR's and loan servicing portfolio (2)	9,006	7,993	6,827	5,751	4,823	
Total interest-sensitive assets	$2,993,361	$2,675,196	$1,904,675	$1,058,378	$559,280	$1,
Transaction accounts:						
Non-interest-bearing checking	$ 44,623	$ 36,473	$ 29,811	$ 24,366	$ 19,916	$
Interest-bearing checking (3)	72,263	59,064	48,276	39,459	32,252	
Money market	16,330	13,348	10,910	8,917	7,288	
Regular passbook	137,740	112,581	92,019	75,212	61,474	
Total transaction accounts .	270,956	221,466	181,016	147,954	120,930	
Average interest rate	2.12%	2.12%	2.12%	2.12%	2.12%	
Certificates of deposit	5,955,136	614,832	19,689	4,746	4,800	
Average interest rate	6.34%	6.30%	5.57%	5.43%	6.10%	
Borrowings	1,491,510	55,928	134	--	1,000	
Average interest rate	6.55%	4.93%	5.76%	-- %	8.75%	
Capital securities	--	--	--	--	--	
Average interest rate	-- %	-- %	-- %	-- %	-- %	
Total deposits, borrowings and capital securities	$7,717,602	$ 892,226	$ 200,839	$ 152,700	$126,730	$1,

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

	December 31,				
	2000	1999	1998	1997	1996
Weighted average yield:					
Loans and mortgage-backed securities	8.45%	7.67%	7.72%	7.95%	7.77%
Federal Home Loan Bank stock	5.52	5.60	5.44	5.88	6.45
Investment securities	6.45	6.12	5.40	5.63	6.02
Earning assets yield	8.36	7.62	7.65	7.87	7.71
Weighted average cost:					
Deposits	5.56	4.72	4.53	5.00	4.86

Borrowings:					
Federal Home Loan Bank advances ..	6.26	5.77	5.47	6.11	5.80
Other borrowings	6.79	7.88	8.69	6.15	5.60
Total borrowings	6.26	5.99	5.51	6.12	5.73
Capital securities	10.00	10.00	--	--	--
Combined funds cost	5.75	5.05	4.66	5.11	4.97
Interest rate spread	2.61%	2.57%	2.99%	2.76%	2.74%

The year-end weighted average yield on our loan portfolio increased to 8.45% at December 31, 2000, from 7.67% at year-end 1999. The weighted average rate on new loans originated during 2000 was 6.10%, compared to 5.92% during 1999 and 6.45% during 1998. At December 31, 2000, our adjustable rate mortgage portfolio of single family residential loans, including mortgage-backed securities, totaled $9.0 billion with a weighted average rate of 8.47%, compared to $7.3 billion with a weighted average rate of 7.52% at December 31, 1999 and $4.3 billion with a weighted average rate of 7.53% at December 31, 1998.

PROBLEM LOANS AND REAL ESTATE

NON-PERFORMING ASSETS

Non-performing assets consist of loans on which we have ceased the accrual of interest, which we refer to as non-accrual loans, loans restructured at a below market rate, real estate acquired in settlement of loans and repossessed automobiles. Non-performing assets totaled $55 million at December 31, 2000, compared to $39 million at December 31, 1999 and $27 million at December 31, 1998. The increase in our non-performing assets during 2000 was primarily attributed to a rise in residential non-performers of which $8.4 million was in the subprime category. Of the total, real estate acquired in settlement of loans, net of allowances, represented $10 million at December 31, 2000, up from $6 million at December 31, 1999 and $4 million at December 31, 1998. When measured as a percentage of total assets, our non-performing assets rose to 0.50% at year-end 2000, compared to 0.42% at year-end 1999 and 0.44% at year-end 1998.

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

	December 31,				
(Dollars in Thousands)	2000	1999	1998	1997	
Non-accrual loans:					
Residential one-to-four units	$20,746	$15,590	$15,571	$20,816	$2
Residential one-to-four units - subprime	22,296	13,914	1,975	--	
Other	1,708	3,477	4,829	20,883	2
Total non-accrual loans	44,750	32,981	22,375	41,699	4
Troubled debt restructure - below market rate (1) ...	206	--	--	--	
Real estate acquired in settlement of loans	9,942	5,899	4,475	9,626	1

Repossessed automobiles	76	314	569	795	
Total non-performing assets	$54,974	$39,194	$27,419	$52,120	$6
Allowance for loan losses (2):					
Amount	$34,452	$38,342	$31,517	$32,092	$3
As a percentage of non-performing loans	76.63%	116.25%	140.86%	76.96%	
Non-performing assets as a percentage of total assets	0.50	0.42	0.44	0.89	

It is our policy to take appropriate, timely and aggressive action when necessary to resolve non-performing assets. When resolving problem loans, it is our policy to determine collectibility under various circumstances which are intended to result in our maximum financial benefit. We accomplish this by either working with the borrower to bring the loan current or by foreclosing and selling the asset. We perform ongoing reviews of loans that display weaknesses and maintain adequate loss allowances on the loans. For a discussion on our internal asset review policy, refer to Allowance for Losses on Loans and Real Estate on page 52.

All but $7.2 million of our non-performing assets at December 31, 2000 were located in California.

We evaluate the need for appraisals for non-performing assets on a periodic basis. We will generally obtain a new appraisal when we believe that there may have been an adverse change in the property operations or in the economic conditions of the geographic market of the property securing our loans. Our policy is to obtain new appraisals at least annually for major real estate acquired in settlement of loans. Throughout 2000, we obtained new appraisals for non-performing loans and real estate acquired in settlement of loans.

Non-Accrual Loans. It is our general policy to account for a loan as non-accrual when the loan becomes 90 days delinquent or when collection of interest appears doubtful. In a number of cases, loans may remain on accrual status past 90 days when we determine that continued accrual is warranted because the loan is well-secured and in process of collection. As of December 31, 2000, we had no loans 90 days or more delinquent which remained on accrual status. We reverse and charge against interest income any interest previously accrued with respect to non-accrual loans. We recognize interest income on non-accrual loans to the extent that we receive payments and to the extent that we believe we will recover the remaining principal balance of the loan. We restore these loans to an accrual status only if all past due payments are made by the borrower and the borrower has demonstrated the ability to make future payments of principal and interest. At December 31, 2000, non-accrual loans aggregating $14 million were less than 90 days delinquent relative to their contractual terms. Additional loans aggregating $1 million were not contractually past due, but were deemed non-accrual due to management's assessment of the borrower's ability to pay.

Troubled Debt Restructurings. We consider a restructuring of a debt a troubled debt restructuring when we, for economic or legal reasons related to the borrower's financial difficulties, grant a concession to the borrower that we would not otherwise grant. Troubled debt restructurings may include changing repayment terms, reducing the stated interest rate or reducing the amounts of principal and/or interest due or extending the maturity date. The restructuring of a loan is intended to recover as much of our investment as possible and to achieve the

highest yield possible. At December 31, 2000 we had less than $1 million of troubled debt restructurings on accrual status representing a single one-to-four unit residential loan.

Real Estate Acquired in Settlement of Loans. Real estate acquired in settlement of loans consists of real estate acquired through foreclosure or deeds in lieu of foreclosure and totaled $10 million at December 31, 2000.

DELINQUENT LOANS

When a borrower fails to make required payments on a loan and does not cure the delinquency within 60 days, we normally record a notice of default to commence foreclosure proceedings, so long as we have given any required prior notice to the borrower. If the loan is not reinstated within the time permitted by law for reinstatement, which is normally five business days prior to the date set for the non-judicial trustee's sale, we may then sell the property at a foreclosure sale. If we have elected to pursue a non-judicial foreclosure, we are not permitted under applicable law to obtain a deficiency judgment against the borrower, even if the security property is insufficient to cover the balance owed. At these foreclosure sales, we generally acquire title to the property.

At December 31, 2000, loans delinquent 30 days or more as a percentage of total loans was 0.66%, up from 0.58% at year-end 1999 and 0.65% at year-end 1998. The increase primarily occurred in our residential one-to-four unit categories. As a percentage of its loan category, residential one-to-four units increased from 0.40% at year-end 1999 to 0.46% at year-end 2000, while subprime residential one-to-four units increased from 1.15% at year-end 1999 to 1.68% at year-end 2000. A higher incidence of delinquency is expected on these subprime loans as these borrowers have a history of delinquencies for which we charge higher interest rates to compensate for that risk. In addition, the loan-to-value ratio on these loans is generally lower thereby providing more equity protection against loss. The increase in our residential one-to-four unit categories was partially offset by a decline in our delinquent automobile loans attributed to the sale of our indirect automobile finance subsidiary.

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

	December 31,					
	2000					
(Dollars in Thousands)	30-59 Days	60-89 Days	90+ Days (1)	Total	30-59 Days	6 D
Loans secured by real estate:						
Residential:						
One-to-four units	$12,400	$ 8,611	$15,246	$36,257	$ 8,630	$3
One-to-four units - subprime	7,300	7,658	14,427	29,385	7,867	3
Five or more units	--	--	--	--	--	
Commercial real estate	--	--	--	--	--	
Construction	--	--	--	--	--	
Land	--	--	--	--	--	

Total real estate loans	19,700	16,269	29,673	65,642	16,497	6
Non-mortgage:						
Commercial	--	--	--	--	--	
Automobile	393	26	151	570	4,758	
Other consumer	98	29	246	373	679	
Total delinquent loans	$20,191	$16,324	$30,070	$66,585	$21,934	$7
Delinquencies as a percentage of total loans	0.20%	0.16%	0.30%	0.66%	0.25%	

	1998					
Loans secured by real estate:						
Residential:						
One-to-four units	$ 9,841	$6,014	$12,832	$28,687	$12,099	$4
One-to-four units - subprime	244	784	947	1,975	185	
Five or more units	--	--	155	155	--	
Commercial real estate	--	--	--	--	--	
Construction	--	--	--	--	--	
Land	--	--	--	--	--	
Total real estate loans	10,085	6,798	13,934	30,817	12,284	4
Non-mortgage:						
Commercial	--	--	--	--	--	
Automobile	4,650	888	1,048	6,586	4,167	
Other consumer	334	45	344	723	218	
Total delinquent loans	$15,069	$7,731	$15,326	$38,126	$16,669	$5
Delinquencies as a percentage of total loans	0.26%	0.13%	0.26%	0.65%	0.31%	

	1996			
Loans secured by real estate:				
Residential:				
One-to-four units	$14,519	$5,502	$18,549	$38,570
One-to-four units - subprime	198	--	--	198
Five or more units	--	--	--	--
Commercial real estate	--	--	--	--
Construction	--	--	--	--
Land	--	--	566	566
Total real estate loans	14,717	5,502	19,115	39,334
Non-mortgage:				
Commercial	--	--	--	--
Automobile	2,080	328	274	2,682
Other consumer	158	15	181	354
Total delinquent loans	$16,955	$5,845	$19,570	$42,370
Delinquencies as a percentage of total loans	0.36%	0.12%	0.41%	0.89%

ALLOWANCE FOR LOSSES ON LOANS AND REAL ESTATE

We maintain a valuation allowance for losses on loans and real estate to provide for losses inherent in those portfolios. The adequacy of the allowance is evaluated quarterly by management to maintain the allowance at levels sufficient to provide for inherent losses. A key component to our evaluation is our internal asset review process.

Our Internal Asset Review Department conducts independent reviews to evaluate the risk and quality of all our assets. Our Internal Asset Review Committee is responsible for the review and classification of assets. The Internal Asset Review Committee members include the Chief Internal Asset Review Officer, Chief Executive Officer, Chief Financial Officer, Chief Lending Officer, General Counsel, Director of Compliance/Risk Management, Credit Administrator and Chief Appraiser. The Internal Asset Review Committee meets quarterly to review and to determine asset classifications and to recommend any changes to asset valuation allowances. With the exception of payoffs or asset sales, the classification of an asset, once established, can be removed or upgraded only upon approval of the Internal Asset Review Committee. The Chief Internal Asset Review Officer reports quarterly to the Audit Committee of the Board of Directors regarding overall asset quality, the adequacy of valuation allowances on classified assets and our adherence to policies and procedures regarding asset classification and valuation.

We adhere to an internal asset review system and loss allowance methodology designed to provide for timely recognition of problem assets and adequate general valuation allowances to cover asset losses. Our current asset monitoring process includes the use of asset classifications to segregate the assets, largely loans and real estate, into various risk categories. We use the various asset classifications as a means of measuring risk for determining the valuation allowance at a point in time. We currently use a six grade system to classify our assets. The current grades are:

- pass;
- watch;
- special mention;
- substandard;
- doubtful; and
- loss.

We consider substandard, doubtful and loss assets "classified assets" for regulatory purposes. A brief description of these classifications follows:

- The pass classification represents a level of credit quality which contains no well-defined deficiency or weakness.
- The watch classification is used to identify an asset that currently contains no well-defined deficiency or weakness, but it is determined to be desirable to closely monitor the asset--e.g., loans to facilitate the sale of real estate acquired in settlement of loans. This category may also be used for assets upgraded from lower classifications where continuing monitoring is deemed appropriate.
- A special mention asset does not currently expose us to a sufficient degree of risk to warrant an adverse classification, but does possess a correctable deficiency or potential weakness deserving management's close attention.

- Substandard assets have a well-defined weakness or weaknesses. They are characterized by the distinct possibility that we will sustain some loss if we do not correct the deficiencies.

- An asset classified doubtful has all the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. We consider doubtful to be a temporary classification until resolution of pending weakness issues enables us to more clearly define the potential for loss.

- That portion of an asset classified as loss is considered uncollectible and of so little value that its continuance as an asset, without establishment of a specific valuation allowance, is not warranted. A loss classification does not mean that an asset has absolutely no recovery or salvage value, but rather it is not reasonable to defer writing off or providing for all or a portion of an impaired asset even though

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partial recovery may be effected in the future. We will generally classify as loss the balance of the asset that is greater than the net fair value of the asset unless we can expect payment from another source. Therefore, the amount of an asset classified as loss reflects the total of specific valuation allowances established for the particular asset. Specific valuation allowances are not includable in determining the Bank's total regulatory capital.

The OTS has the authority to require us to change our asset classifications. If the change results in an asset being classified in whole or in part as loss, a specific allowance must be established against the amount so classified or that amount must be charged off. OTS guidelines set forth quantitative benchmarks as a starting point for the determination of appropriate levels of general valuation allowances. The OTS directs its examiners to rely on management's estimates of adequate general valuation allowances if the Bank's process for determining adequate allowances is deemed to be sound.

Our policy is to provide an allowance for losses on loans and real estate when it is probable that the value of the asset has been impaired and the loss can be reasonably estimated. To comply with this policy, we have established a monitoring system that requires at least an annual review of all assets in excess of $5 million and a semiannual review of all assets considered adversely classified or criticized. The monitoring system requires a review of current operating statements, an evaluation of the property's current and past performance, an evaluation of the borrower's ability to repay and the preparation of a discounted cash flow analysis. Based on the results of the review, we may require a new appraisal.

We utilize the asset classifications from our internal asset review process in the following manner to determine the amount of our allowances:

- General valuation allowances: This element relates to assets with no well-defined deficiency or weakness (i.e., assets classified pass or watch) and takes into consideration loss that is imbedded within the portfolio but has not yet been realized. Generally, we believe that borrowers are impacted by events well in advance of a lender's knowledge that may ultimately result in loan default and eventual

loss. Examples of such loss-causing events would be borrower job loss, divorce or medical crisis in the case of single family residential and consumer loans, or loss of a major tenant in the case of commercial real estate loans. General valuation allowances are determined by applying factors that take into consideration past loss experience and asset duration for each major asset type to the associated asset balance.

- Allocated allowances: This element relates to assets with well-defined deficiencies or weaknesses (i.e., assets classified special mention, substandard, doubtful or loss). We calculate on an ongoing basis loss by credit classification for each major asset type. Factors based upon those loss statistics are applied against current classified asset balances to determine the amount of allocated allowances. Included in these allowances are those amounts associated with assets where it is probable that the value of the asset has been impaired and the loss can be reasonably estimated. If we determine the net fair value of the asset exceeds our carrying value, a specific allowance is recorded for the amount of that difference.

- Unallocated allowance: This element is more subjective and is reviewed quarterly to take into consideration estimation errors and economic trends that are not necessarily captured in determining the general valuation and allocated allowances.

Our provision for loan losses was $3.3 million in 2000, down $8.0 million from 1999. Although the provision for loan losses exceeded our net loan charge-offs by $1.9 million, the allowance for loan losses declined by $3.9 million to $34.5 million at December 31, 2000. The decline in the allowance reflected a decrease of $3.6 million in general valuation allowances to $27.0 million due primarily to a reduction of $5.5 million associated with the sale of the indirect automobile finance subsidiary which more than offset an increase related to increases in one-to-four unit residential loans. Allocated allowances declined by $0.2 million of which $0.3 million was associated with the subsidiary sale. There was no change in the unallocated allowance of $2.8 million. During 1999, our provision for loan losses exceeded net loan charge-offs by $6.8 million resulting in an increase in the allowance for loan losses to $38.3 million at December 31, 1999. The allowance increase reflected an increase of $6.2 million in general valuation allowances to $30.6 million due primarily to the increase during the year in the overall one-to-four unit residential loan portfolio, while allocated allowances increased $0.6 million to $4.9 million due primarily to an increase in loans classified substandard. There was no change in the unallocated allowance.

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

(In Thousands)	2000	1999	1998	1997	1996
Balance at beginning of period	$38,342	$31,517	$32,092	$30,094	$27,943
Provision	3,251	11,270	3,899	8,640	9,137
Charge-offs	(1,749)	(5,535)	(7,372)	(7,773)	(7,660)
Recoveries	419	1,090	2,898	1,131	674
Transfers (1)	(5,811)	--	--	--	--

Balance at end of period	$34,452	$38,342	$31,517	$32,092	$30,094

Net loan charge-offs were $1.3 million in 2000, down from $4.4 million in 1999 and $4.5 million in 1998. The decline in net loan charge-offs in 2000 primarily reflected a decline of $3.3 million in net charge-offs of automobile loans due to the previously mentioned sale of subsidiary, partially offset by a $0.1 million increase in net charge-offs of one-to-four unit residential loans.

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

(Dollars in Thousands)	2000	1999	1998	1997	
Gross loan charge-offs:					
Loans secured by real estate:					
Residential:					
One-to-four units (1)	$ 419	$ 393	$ 1,035	$2,389	$
One-to-four units - subprime	316	187	--	--	
Five or more units	--	--	68	--	
Commercial real estate	--	--	--	--	
Land	--	--	--	--	
Non-mortgage:					
Commercial	--	--	--	--	
Automobile	832	4,795	6,118	5,109	
Other consumer	182	160	151	275	
Total gross loan charge-offs	1,749	5,535	7,372	7,773	
Gross loan recoveries:					
Loans secured by real estate:					
Residential:					
One-to-four units	19	--	125	224	
One-to-four units - subprime	--	--	--	--	
Five or more units	--	--	--	--	
Commercial real estate	250	250	1,610	261	
Land	--	--	--	--	
Non-mortgage:					
Commercial	--	--	--	--	
Automobile	136	831	1,159	641	
Other consumer	14	9	4	5	
Total gross loan recoveries	419	1,090	2,898	1,131	
Net loan charge-offs:					
Loans secured by real estate:					
Residential:					
One-to-four units	400	393	910	2,165	
One-to-four units - subprime	316	187	--	--	
Five or more units	--	--	68	--	
Commercial real estate	(250)	(250)	(1,610)	(261)	
Land	--	--	--	--	
Non-mortgage:					

Commercial	--	--	--	--	
Automobile	696	3,964	4,959	4,468	
Other consumer	168	151	147	270	
Total net loan charge-offs	$1,330	$4,445	$ 4,474	$6,642	$
Net loan charge-offs as a percentage of average loans	0.01%	0.06%	0.08%	0.13%	

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The allocation of the allowance for loan losses at the dates indicated is as shown in the following table.

	December 31,						
	2000			1999			
(Dollars in Thousands)	Allowance	Gross Loan Portfolio Balance	Allowance Percentage to Loan Balance	Allowance	Gross Loan Portfolio Balance	Allowance Percentage to Loan Balance	A
Loans secured by real estate:							
Residential:							
One-to-four units	$15,254	$7,655,238	0.20%	$12,913	$6,155,399	0.21%	
One-to-four units-subprime	10,157	1,743,914	0.58	9,876	1,639,401	0.60	
Five or more units	146	19,460	0.75	184	21,055	0.87	
Commercial real estate	2,935	164,604	1.78	2,439	148,327	1.64	
Construction	1,390	118,165	1.18	2,075	176,487	1.18	
Land	332	26,880	1.24	843	67,631	1.25	
Non-mortgage:							
Commercial	442	21,721	2.03	334	26,667	1.25	
Automobile (1)	269	39,614	0.68	6,259	399,789	1.57	
Other consumer	727	60,653	1.20	619	49,344	1.25	
Not specifically allocated	2,800	--	--	2,800	--	--	
Total loans held for investment	$34,452	$9,850,249	0.35%	$38,342	$8,684,100	0.44%	
	1997			1996			
Loans secured by real estate:							
Residential:							
One-to-four units	$13,396	$4,358,475	0.31%	$12,960	$4,013,190	0.32%	
One-to-four units-subprime	1,256	249,070	0.50	281	33,258	0.84	
Five or more units	314	38,278	0.82	517	56,907	0.91	
Commercial real estate	4,112	202,425	2.03	6,956	260,609	2.67	
Construction	847	70,865	1.20	773	66,651	1.16	
Land	331	25,687	1.29	466	21,177	2.20	
Non-mortgage:							
Commercial	196	26,024	0.75	236	22,136	1.07	
Automobile	8,016	342,326	2.34	4,303	202,186	2.13	
Other consumer	824	47,735	1.73	802	47,281	1.70	

Not specifically allocated	2,800	--	--	2,800	--	--
Total loans held for investment	$32,092	$5,360,885	0.60%	$30,094	$4,723,395	0.64%

Impaired Loans. We consider a loan to be impaired when, based upon current information and events, we believe it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. We carry impaired loans at either the present value of expected future cash flows discounted at the loan's effective interest rate or at the loan's observable market price or the net fair value of the collateral securing the loan. Impaired loans exclude large groups of smaller balance homogeneous loans that we collectively evaluate for impairment. For us, loans we collectively review for impairment include all single family loans and performing multi-family and non-residential loans having principal balances of less than $5 million.

In determining impairment, we consider large non-homogeneous loans with the following characteristics: non-accrual loans, debt restructurings and performing loans which exhibit, among other characteristics, high loan-to-value ratios or delinquent taxes. We base the measurement of collateral dependent impaired loans on the fair value of the loan's collateral. We value non-collateral dependent loans based on a present value calculation of expected future cash flows, discounted at the loan's effective rate. We generally use cash receipts on impaired loans not performing according to contractual terms to reduce the carrying value of the loan, unless we believe we will recover the remaining principal balance of the loan. We include impairment losses in the allowance for loan losses through a charge to provision for loan losses. We include adjustments to impairment losses due to changes in the fair value of the collateral of impaired loans in provision for loan losses. Upon disposition of an impaired loan, we record loss of principal through a charge-off to the allowance for loan losses. At December 31, 2000, the recorded investment in loans for which we have recognized impairment totaled $14 million, up from $13 million at December 31, 1999. The total allowance for losses related to these loans was $1 million for both

December 31, 2000 and 1999. During 2000, the total interest recognized on the impaired portfolio was $2.9 million, compared to $1.9 million in 1999. For further information regarding impaired loans, see Note 6 of the Notes to Consolidated Financial Statements on page 78.

A summary of the activity in the allowance for loan losses associated with impaired loans is shown below for the years indicated. We have recorded provisions and reductions to the allowance associated with changes in classification of loans as impaired and reductions due to loan principal payments.

(In Thousands)	2000	1999	1998	1997	1996
Balance at beginning of period	$ 797	$ 810	$1,301	$4,402	$5,292
Provision (reduction)	3	(13)	(491)	(3,101)	(890)
Charge-offs	--	--	--	--	--

Recoveries	--	--	--	--	--
Balance at end of period	$ 800	$ 797	$ 810	$1,301	$4,402

The following table is a summary of the activity in our allowance for real estate and joint ventures held for investment during the years indicated. The provision reductions in all years were, in general, due to a continuing improvement in the real estate market which favorably impacted the valuation of certain neighborhood shopping center investments and to a reduction in the investment in certain joint venture investments.

(In Thousands)	2000	1999	1998	1997	1996
Balance at beginning of period	$2,131	$ 7,717	$21,244	$30,071	$34,338
Provision (reduction)	866	(3,666)	(5,296)	(3,190)	(3,306)
Charge-offs	--	(1,920)	(8,231)	(5,637)	(1,035)
Recoveries	--	--	--	--	74
Balance at end of period	$2,997	$ 2,131	$ 7,717	$21,244	$30,071

In addition to losses charged against the allowance for loan losses, we have recorded losses on real estate acquired in settlement of loans by direct write-off to net operations of real estate acquired in settlement of loans and against an allowance for losses specifically established for these assets. As of September 30, 1999, we are no longer maintaining an allowance for real estate acquired in settlement of loans as we record the related individual assets at the lower of cost or fair value.

The following table is a summary of the activity of our allowance for real estate acquired in settlement of loans during the years indicated.

(In Thousands)	2000	1999	1998	1997	1996
Balance at beginning of period	$--	$ 533	$ 839	$ 1,078	$ 1,217
Provision (reduction)	412	(45)	455	1,107	1,658
Charge-offs	(442)	(488)	(761)	(1,346)	(1,797)
Recoveries	30	--	--	--	--
Balance at end of period	$--	$--	$ 533	$ 839	$ 1,078

CAPITAL RESOURCES AND LIQUIDITY

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

Our primary sources of funds generated during 2000 were from:

- principal repayments--including prepayments, but excluding our refinances of our existing loans--on loans and mortgage-backed securities of $1.8 billion; and
- a net deposit inflow of $1.5 billion, all of which was in certificates of deposit.

We used these funds primarily to originate loans held for investment of $3.3 billion.

To the extent 2001 deposit growth falls short of satisfying ongoing commitments to fund maturing and withdrawable deposits, repay borrowings, fund existing and future loans and make investments, continue branch improvement programs and maintain regulatory liquidity requirements, we will utilize borrowing arrangements with the FHLB and other sources. At December 31, 2000, we had commitments to fund loans amounting to $694 million, undisbursed loan funds and unused lines of credit of $148 million, and other contingent liabilities of $2 million. We believe our current sources of funds will enable us to meet these obligations while maintaining our liquidity at appropriate levels.

The principal measure of liquidity in the savings and loan industry is the regulatory ratio of cash and eligible investments to the sum of withdrawable savings and borrowings due within one year. Federal regulators reduced the minimum liquidity ratio in 1997 from 5% to 4%. At December 31, 2000, the Bank's ratio was 4.3%, compared to 4.2% at December 31, 1999, and 4.0% at December 31, 1998.

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

REGULATORY CAPITAL COMPLIANCE

The core and tangible capital ratios were 6.42% and the risk-based capital ratio was 12.94% at December 31, 2000. These levels are up slightly from comparable ratios of 6.27% for core and tangible capital and 12.14% for risk-based capital at December 31, 1999, and continue to exceed the "well capitalized" standards of 5.00% for core capital and 10.00% for risk-based capital, as defined by regulation. During 2000, the amount of the Bank's non-includable investment in real estate required to be deducted from regulatory capital was reduced by $28 million due primarily to DSL Service Company's return of $32 million of capital to the Bank associated with the sale of certain real estate investments.

The following table is a reconciliation of the Bank's stockholder's equity to federal regulatory capital as of December 31, 2000.

	Tangible Capital	Core Capital

(Dollars in Thousands)	Amount	Ratio	Amount	Ratio
Stockholder's equity	$722,829		$722,829	
Adjustments:				
Deductions:				
Investment in subsidiary, primarily real estate .	(17,230)		(17,230)	
Goodwill	(3,607)		(3,607)	
Non-permitted mortgage servicing rights	(4,073)		(4,073)	
Additions:				
Unrealized gains on securities available for sale	(687)		(687)	
General loss allowance - investment in DSL Service Company	483		483	
Allowance for loan losses, net of specific allowances (1)	--		--	
Regulatory capital	697,715	6.42%	697,715	6.42%
Well capitalized requirement	162,896	1.50 (2)	542,985	5.00
Excess	$534,819	4.92%	$154,730	1.42%

CURRENT ACCOUNTING ISSUES

Statement of Financial Accounting Standards No. 140. In September 2000, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities - a replacement of FASB Statement No. 125," which revises the standards for accounting for securitizations and other transfers of financial assets and collateral and requires certain disclosures. Although it replaces FASB Statement No. 125, it carries over most of statement 125's provisions without reconsideration.

The accounting provisions are effective for fiscal years beginning after March 15, 2001. The reclassification and disclosure provisions are effective for fiscal years beginning after December 15, 2000. It is not anticipated that the financial impact of this statement will have a material effect on Downey.

Statement of Financial Accounting Standards No. 133. In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133").

SFAS 133 establishes accounting and reporting standards for derivative instruments, including a number of derivative instruments embedded in other contracts, collectively referred to as derivatives, and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. If specific conditions are met, a derivative may be specifically designated as:

- a hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment;

- a hedge of the exposure to variable cash flows of a forecasted transaction; or

- a hedge of the foreign currency exposure of a net investment in a foreign operation, an unrecognized firm commitment, an available for sale security or a foreign-currency-denominated forecasted

transaction.

Under SFAS 133, an entity that elects to apply hedge accounting is required to establish at the inception of the hedge the method it will use for assessing the effectiveness of the hedging derivative and the measurement

approach for determining the ineffective aspect of the hedge. Those methods must be consistent with the entity's approach to managing risk.

This statement is effective for all fiscal quarters of fiscal years beginning after June 15, 2000.

As part of our secondary marketing activities, we utilize forward sale and purchase derivative contracts to hedge the value of loans originated for sale against adverse changes in interest rates. At December 31, 2000, sales contracts amounted to approximately $150 million. These contracts have a high correlation to the price movement of the loans being hedged. There is no recognition of unrealized gains and losses on these contracts in the balance sheet or statement of income. When the related loans are sold, the deferred gains or losses from these contracts are recognized in the statement of income as a component of net gains or losses on sales of loans and mortgage-backed securities.

On January 1, 2001, we adopted SFAS 133, and at that time, designated those sales contracts as cash flow derivative instruments in accordance with the requirements of the new standard. These cash flow derivative instruments hedge the variability of forecasted cash flows attributable to interest rate risk. Cash flow hedges are accounted for by recording the value of the derivative instrument on the balance sheet as either an asset or liability with a corresponding offset recorded in other comprehensive income within stockholders' equity, net of tax. Amounts are reclassified from other comprehensive income to the income statement in the period the hedged cash flow occurs. Derivative gains and losses not considered effective in hedging the change in expected cash flows of the hedged item are recognized immediately in the income statement.

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

(In Thousands)	2001
SUMMARY OF TRANSITION ADJUSTMENT AT JANUARY 1:	
BALANCE SHEET	
ASSETS	
Other assets	$ 244
Deferred income tax benefit	260
	$ 504
LIABILITIES AND STOCKHOLDERS' EQUITY	
Accounts payable and accrued liabilities	$ 856
Accumulated other comprehensive loss - unrealized losses on derivative instruments	(388)
Retained earnings	36

	$ 504
STATEMENT OF INCOME	
Cumulative effect of a change in accounting principle	$ 62
Income taxes	26
Net income	$ 36

The transition adjustment will be presented as a cumulative effect adjustment as described in Accounting Principles Board Opinion No. 20, Accounting Changes, in our 2001 financial statements. The transition amounts were determined based on the interpretive guidance issued to date by the Financial Accounting Standards Board. The Financial Accounting Standards Board continues to issue interpretive guidance which could require changes in our application of the standard and adjustment to the transition amounts. We will continue to hedge as we have previously done; however, SFAS 133, as applied to our risk management strategies, may increase or decrease reported net income and stockholders' equity prospectively, depending on future levels of interest rates and other variables affecting the fair values of derivative instruments and hedged items, but will have no effect on cash flows or the overall economics of the transactions. For further information regarding current accounting issues, see Note 1 of the Notes to Consolidated Financial Statements on page 69.

SALE OF SUBSIDIARY

On February 29, 2000, the Bank sold its indirect automobile finance subsidiary, Downey Auto Finance Corp., to Auto One Acceptance Corp., a subsidiary of California Federal Bank and recognized a pre-tax gain from the sale of $9.8 million. At December 31, 1999, Downey Auto Finance Corp. had loans totaling $366 million and total assets of $373 million. The proceeds from the sale have provided additional capital to further the growth of our residential lending business.

ITEM 8. FINANCIAL STATEMENTS

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KPMG
355 South Grand Avenue
Los Angeles, CA 90071

INDEPENDENT AUDITORS' REPORT

The Board of Directors and Stockholders
Downey Financial Corp.:

We have audited the accompanying consolidated balance sheets of Downey Financial Corp. and subsidiaries ("Downey") as of December 31, 2000 and 1999, and the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2000. These consolidated financial statements are the responsibility of Downey's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Downey Financial Corp. and subsidiaries as of December 31, 2000 and 1999, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States of America.

/s/ KPMG LLP

Los Angeles, California
January 17, 2001

DOWNEY FINANCIAL CORP. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(Dollars in Thousands, Except Per Share Data)	Decemb 2000
ASSETS	
Cash	$ 108,202
Federal funds	19,601
Cash and cash equivalents	127,803
U.S. Treasury securities, agency obligations and other investment securities available for sale, at fair value	305,615
Municipal securities held to maturity, at amortized cost (estimated market value of $6,534 at December 31, 2000, and $6,710 at December 31, 1999)	6,550
Loans held for sale, at lower of cost or market	251,572
Mortgage-backed securities available for sale, at fair value	10,203
Loans receivable held for investment	9,822,578
Investments in real estate and joint ventures	17,641
Real estate acquired in settlement of loans	9,942
Premises and equipment	104,178
Federal Home Loan Bank stock, at cost	106,356
Mortgage servicing rights, net	40,731
Other assets	90,694
	$10,893,863
LIABILITIES AND STOCKHOLDERS' EQUITY	
Deposits	$ 8,082,689
Federal Home Loan Bank advances	1,978,348
Other borrowings	224
Accounts payable and accrued liabilities	54,236
Deferred income taxes	33,730
Total liabilities	10,149,227
Company obligated mandatorily redeemable capital securities of subsidiary trust holding solely junior subordinated debentures of the Company ("Capital Securities")	120,000
STOCKHOLDERS' EQUITY	
Preferred stock, par value of $0.01 per share; authorized 5,000,000 shares; outstanding none	--
Common stock, par value of $0.01 per share; authorized 50,000,000 shares; outstanding 28,205,741 shares at December 31, 2000, and 28,148,409 shares at December 31, 1999	282
Additional paid-in capital	93,239
Accumulated other comprehensive income (loss) - unrealized gains (losses) on securities available for sale	687
Retained earnings	530,428
Total stockholders' equity	624,636
	$10,893,863

See accompanying notes to consolidated financial statements.

DOWNEY FINANCIAL CORP. AND SUBSIDIARIES
Consolidated Statements of Income

(Dollars in Thousands, Except Per Share Data)	Years E
	2000
Interest income:	
Loans receivable	$ 760,538 $
U.S. Treasury securities and agency obligations	13,387
Mortgage-backed securities	1,060
Other investments	9,375
Total interest income	784,360
Interest expense:	
Deposits	379,303
Borrowings	130,419
Capital securities	12,163
Total interest expense	521,885
Net interest income	262,475
Provision for loan losses	3,251
Net interest income after provision for loan losses	259,224
Other income, net:	
Loan and deposit related fees	30,089
Real estate and joint ventures held for investment, net:	
Operations, net	6,683
Net gains on sales of wholly owned real estate	2,981
(Provision for) reduction of losses on real estate and joint ventures	(866)
Secondary marketing activities:	
Loan servicing fees	(3,628)
Net gains on sales of loans and mortgage-backed securities	3,297
Net gains (losses) on sales of investment securities	(106)
Gain on sale of subsidiary	9,762
Other	2,342
Total other income, net	50,554
Operating expense:	
Salaries and related costs	82,522
Premises and equipment costs	23,220
Advertising expense	4,786
Professional fees	3,319
SAIF insurance premiums and regulatory assessments	2,626
Other general and administrative expense	19,716
Total general and administrative expense	136,189
Net operation of real estate acquired in settlement of loans	818

Amortization of excess of cost over fair value of net assets acquired ..		462
Total operating expense		137,469
Income before income taxes		172,309
Income taxes		73,058
Net income	$	99,251
PER SHARE INFORMATION:		
Basic	$	3.52
Diluted	$	3.51
Cash dividends declared and paid	$	0.36
Weighted average diluted shares outstanding		28,225,551

See accompanying notes to consolidated financial statements.

DOWNEY FINANCIAL CORP. AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income

	Years E
(In Thousands)	2000
Net income	$ 99,251
Other comprehensive income (loss), net of income taxes (benefits):	
Unrealized gains (losses) on securities available for sale:	
U.S. Treasury securities, agency obligations and other investment securities available for sale, at fair value	2,032
Mortgage-backed securities available for sale, at fair value	173
Less reclassification of realized gains (losses) included in net income ...	(50)
Total other comprehensive income (loss), net of income taxes (benefits)	2,255
Comprehensive income	$ 101,506

Consolidated Statements of Stockholders' Equity

(Dollars in Thousands, Except Per Share Data)	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)
Balances at December 31, 1997	$ 268	$ 45,954	$ 110

Cash dividends, $0.32 per share	--	--	--	
Stock dividend	13	45,702	--	
Exercise of stock options	--	510	--	
Unrealized gains on securities available for sale	--	--	643	
Net income	--	--	--	
Balances at December 31, 1998	281	92,166	753	
Cash dividends, $0.35 per share	--	--	--	
Exercise of stock options	--	219	--	
Unrealized losses on securities available for sale	--	--	(2,321)	
Net income	--	--	--	
Balances at December 31, 1999	281	92,385	(1,568)	
Cash dividends, $0.36 per share	--	--	--	
Exercise of stock options	1	854	--	
Unrealized gains on securities available for sale	--	--	2,255	
Net income	--	--	--	
Balances at December 31, 2000	$ 282	$ 93,239	$ 687	$

See accompanying notes to consolidated financial statements.

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DOWNEY FINANCIAL CORP. AND SUBSIDIARIES
Consolidated Statements of Cash Flows

	Years	
(In Thousands)	2000	
Cash flows from operating activities:		
Net income	$ 99,251	$
Adjustments to reconcile net income to net cash used for operating activities:		
Depreciation and amortization	32,957	
Provision for (recovery of) losses on loans, real estate acquired in settlement of loans, investments in real estate and joint ventures and other assets	4,527	
Net gains on sales of loans and mortgage-backed securities, investment securities, real estate and other assets	(10,111)	
Gain on sale of subsidiary	(9,762)	
Interest capitalized on loans (negative amortization)	(72,641)	
Federal Home Loan Bank stock dividends	(7,522)	
Loans originated for sale	(1,729,220)	
Proceeds from sales of:		
Loans held for sale	586,728	
Mortgage-backed securities available for sale	963,712	
Increase in other, net	(27,160)	
Net cash provided by (used for) operating activities	(169,241)	
Cash flows from investing activities: Proceeds from sales of:		
Subsidiary, net	379,234	

U.S. Treasury securities, agency obligations and other investment securities available for sale	29,645
Loans held for investment	99,751
Wholly owned real estate and real estate acquired in settlement of loans	38,707
Federal Home Loan Bank stock	17,516
Proceeds from maturities of U.S. Treasury securities, agency obligations and other investment securities available for sale	22,000
Purchase of:	
U.S. Treasury securities, agency obligations and other investment securities available for sale	(181,905)
Loans receivable held for investment	(18,828)
Federal Home Loan Bank stock	(13,958)
Loans receivable originated held for investment (net of refinances of $165,148 at December 31, 2000, $145,316 at December 31, 1999 and $120,638 at December 31, 1998)	(3,317,104)
Principal payments on loans receivable held for investment and mortgage-backed securities available for sale	1,823,685
Net change in undisbursed loan funds	(59,588)
Investments in real estate held for investment	(1,356)
Other, net	(8,334)
Net cash provided by (used for) investing activities	(1,190,535)

See accompanying notes to consolidated financial statements.

DOWNEY FINANCIAL CORP. AND SUBSIDIARIES
Consolidated Statements of Cash Flows (Continued)

	Year
(In Thousands)	2000
Cash flows from financing activities:	
Net increase in deposits	$ 1,519,928
Net decrease in securities sold under agreements to repurchase	--
Proceeds from Federal Home Loan Bank advances	6,059,445
Repayments of Federal Home Loan Bank advances	(6,203,504)
Net decrease in other borrowings	(149)
Proceeds from issuance of capital securities, net	--
Proceeds from exercise of stock options	855
Cash dividends	(10,143)
Net cash provided by financing activities	1,366,432
Net increase in cash and cash equivalents	6,656
Cash and cash equivalents at beginning of period	121,147
Cash and cash equivalents at end of period	$ 127,803
Supplemental disclosure of cash flow information:	
Cash paid during the period for:	

Interest	$ 511,943
Income taxes	73,744
Supplemental disclosure of non-cash investing:	
Loans transferred from (to) held for investment to (from) held for sale	54,993
Loans exchanged for mortgage-backed securities	970,319
Real estate acquired in settlement of loans	18,389
Loans to facilitate the sale of real estate acquired in settlement of loans	6,896

See accompanying notes to consolidated financial statements.

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DOWNEY FINANCIAL CORP. AND SUBSIDIARIES
Notes to Consolidated Financial Statements----(Continued)
For the Years Ended December 31, 2000, 1999 and 1998

(1) Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements of Downey Financial Corp. and subsidiaries ("Downey") include all accounts of Downey Financial Corp. and the consolidated accounts of all subsidiaries, including Downey Savings and Loan Association, F.A. (the "Bank"). All significant intercompany balances and transactions have been eliminated.

Business

Downey provides a full range of financial services to individual and corporate customers. Downey is subject to competition from other financial institutions. Downey is subject to the regulations of certain governmental agencies and undergoes periodic examinations by those regulatory authorities.

Basis of Financial Statement Presentation

The consolidated financial statements have been prepared in conformity with generally accepted accounting principles. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the dates of the balance sheets and the results of operations for the reporting periods. Actual results could differ significantly from those estimates.

Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowances for losses on loans, real estate and mortgage servicing rights ("MSRs"). Management believes that the allowances established for losses on loans, real estate and MSRs are adequate. While management uses available information to recognize losses on loans, real estate and MSRs, future additions to the allowances may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review Downey's allowances for losses on loans, real estate and MSRs. Such agencies may require Downey to recognize additions to the allowances based on their judgments about information

available to them at the time of their examination.

Downey is required to carry its loans held for sale portfolio, mortgage-backed and investment securities available for sale portfolio, real estate acquired in settlement of loans, real estate held for investment or under development and MSRs at the lower of cost or fair value or in certain cases, at fair value. Fair value estimates are made at a specific point in time based upon relevant market information and other information about the asset. Such estimates related to the mortgage-backed and investment securities portfolios include published bid prices or bid quotations received from securities dealers. Fair value estimates for real estate acquired in settlement of loans and real estate held for investment or under development is determined by current appraisals and, where no active market exists for a particular property, discounting a forecast of expected cash flows at a rate commensurate with the risk involved.

Cash and Cash Equivalents

For purposes of the statements of cash flows, cash and cash equivalents include cash on hand, amounts due from banks, certificates of deposit with maturities three months or less and federal funds sold. Generally, federal funds are purchased and sold for one-day periods.

Mortgage-Backed Securities Purchased Under Resale Agreements, U.S. Treasury Securities and Agency Obligations, Other Investment Securities, Municipal Securities and Mortgage-Backed Securities

Downey has established written guidelines and objectives for its investing activities. At the time of purchase of a mortgage-backed security purchased under resale agreement, U.S. Treasury security and agency obligation, other investment security, municipal security or a mortgage-backed security, management of Downey designates the security as either held to maturity, available for sale or held for trading based on Downey's investment objectives, operational needs and intent. Downey then monitors its investment activities to ensure that those activities are consistent with the established guidelines and objectives.

Held to Maturity. Securities held to maturity are carried at cost, adjusted for amortization of premiums and accretion of discounts which are recognized in interest income using the interest method. Mortgage-backed securities represent participating interests in pools of long-term first mortgage loans originated and serviced by the issuers of the securities. Mortgage-backed securities held to maturity are carried at unpaid principal balances, adjusted for unamortized premiums and unearned discounts. Premiums and discounts on mortgage-backed securities are amortized using the interest method over the remaining period to contractual maturity, adjusted for anticipated prepayments. It is the positive intent of Downey, and Downey has the ability, to hold these securities until maturity as part of its portfolio of long-term, interest-earning assets. If the cost basis of these securities is determined to be other than temporarily impaired, the amount of the impairment is charged to operations.

Available for Sale. Securities available for sale are carried at fair value. Premiums and discounts are amortized using the interest method over the remaining period to contractual maturity and, in the case of

mortgage-backed securities, adjusted for anticipated prepayments. Unrealized holding gains and losses, or valuation allowances established for net unrealized losses, are excluded from earnings and reported as a separate component of stockholders' equity as accumulated other comprehensive income, net of income taxes, unless the security is deemed other than temporarily impaired. If the security is determined to be other than temporarily impaired, the amount of the impairment is charged to operations.

Realized gains and losses on the sale of securities available for sale, determined using the specific identification method and recorded on a trade date basis, are reflected in earnings.

Held for Trading. Securities held for trading are carried at market value. Realized and unrealized gains and losses are reflected in earnings.

Loans Held for Sale

Downey identifies those loans which foreseeably may be sold prior to maturity. These loans have been classified as held for sale in the Consolidated Balance Sheets and are recorded at the lower of amortized cost or market value. In response to unforeseen events such as changes in regulatory capital requirements, liquidity shortfalls, changes in the availability of sources of funds and excess loan demand by borrowers that could not be controlled immediately by loan price changes, Downey may sell loans which had been held for investment. In such occurrences, the loans are transferred at amortized cost and the lower of cost or market method is then applied.

Gains or Losses on Sales of Loans and Mortgage Servicing Assets

Gains or losses on sales of loans are recognized at the time of sale and are determined by the difference between the net sales proceeds and the allocated basis of the loans sold. Downey capitalizes MSRs acquired through either the purchase or origination of mortgage loans for sale or securitization with servicing rights retained. The total cost of the mortgage loans designated for sale is allocated to the MSRs and the mortgage loans without the MSRs based on their relative fair values. The MSRs are included as a component of gain on sale of loans. The MSRs are amortized in proportion to and over the estimated period of net servicing income. Such amortization is reflected as a component of loan servicing fees.

The MSRs are periodically reviewed for impairment based on their fair value. The fair value of the MSRs, for the purposes of impairment, is measured using a discounted cash flow analysis based on market-adjusted discount rates and anticipated prepayment speeds. Market sources are used to determine prepayment speeds, the net cost of servicing per loan, and inflation, default and interest rates for mortgages.

The Company capitalizes and measures impairment on a disaggregated basis based on the following predominant risk characteristics of the underlying mortgage loans: fixed-rate mortgage loans by loan term and coupon rate (less than 7%, 150 basis point increments between 7% and 10%, and greater than 10%), and loan term for adjustable rate mortgages. Impairment losses

are recognized through a valuation allowance for each impaired stratum, with any associated provision recorded as a component of loan servicing fees.

Derivative Financial Instruments

As part of its secondary marketing activities, Downey utilizes forward sale contracts to hedge the value of loans originated for sale against adverse changes in interest rates. These contracts have a high correlation to the price movement of the loans being hedged. There is no recognition of unrealized gains and losses on these contracts in the balance sheet or statement of income. When the related loans are sold, the deferred gains or losses from these contracts are recognized in the statement of income as a component of net gains or losses on sales of loans and mortgage-backed securities.

Loans Receivable Held for Investment

Loans receivable are recorded at cost, net of discounts and premiums, undisbursed loan proceeds, net deferred fees and costs and the allowance for loan losses.

Interest income on loans is accrued based on the outstanding principal amount of loans using the interest method. Discounts and premiums on loans are amortized to income using the interest method over the remaining period to contractual maturity. The amortization of discounts into income is discontinued on loans that are contractually ninety days past due or when collection of interest appears doubtful.

Loan origination fees and related incremental direct loan origination costs are deferred and amortized to income using the interest method over the contractual life of the loans, adjusted for actual prepayments. Fees received for a commitment to originate or purchase a loan or group of loans are deferred and, if the commitment is exercised, recognized over the life of the loan as an adjustment of yield or, if the commitment expires unexercised, recognized as income upon expiration of the commitment. The amortization of deferred fees and costs is discontinued on loans that are contractually ninety days past due or when collection of interest appears doubtful.

Accrued interest on loans that are contractually ninety days or more past due or when collection of interest appears doubtful is generally reversed and charged against interest income. Income is subsequently recognized only to the extent cash payments are received and the principal balance is expected to be recovered. Such loans are restored to an accrual status only if the loan is brought contractually current and the borrower has demonstrated the ability to make future payments of principal and interest.

Allowance for Loan Losses

The allowance for loan losses is maintained at an amount management deems adequate to cover inherent losses. Downey has implemented and adheres to an internal asset review system and loan loss allowance methodology designed to provide for the detection of problem assets and an adequate allowance to cover loan losses. In determining the allowance for loan losses related to specific major loans (loans over $5 million), management evaluates its allowance on an individual loan basis, including an analysis of the creditworthiness, cash flows and financial status of the borrower, and the condition and the estimated value of the collateral. Downey reviews all loans under $5 million by analyzing their performance and

composition of their collateral as a whole, because of the relatively homogeneous nature of the portfolios. Given the above evaluations, the amount of the allowance is based upon the summation of general valuation allowances, allocated allowances and an unallocated allowance. General valuation allowances relate to loans with no well-defined deficiency or weakness and are determined by applying against such loans factors for each major loan category that consider past loss experience and loan duration. Allocated allowances relate to loans with well-defined deficiencies or weaknesses and are generally determined by loss factors that consider past loss experience for such loans or are determined by the excess of the recorded investment in the loan over the fair value of the collateral, where appropriate. The unallocated allowance is more subjective and is reviewed quarterly to take into consideration estimation errors and other factors such as prevailing and forecasted economic conditions.

Downey considers a loan to be impaired when, based upon current information and events, it believes it is probable that Downey will be unable to collect all amounts due according to the contractual terms of the loan agreement. In determining impairment, Downey considers large non-homogeneous loans with the following characteristics: non-accrual loans, debt restructurings and performing loans which exhibit, among other characteristics, high loan-to-value ratios or delinquent taxes. Downey bases the measurement of collateral dependent impaired loans on the fair value of the loan's collateral. Non-collateral dependent loans are valued based on a present value calculation of expected future cash flows, discounted at the loan's effective rate. Cash receipts on impaired loans not performing according to contractual terms are generally used to reduce the carrying value of the loan, unless Downey believes it will recover the remaining principal balance of the loan. Impairment losses are included in the allowance for loan losses through a charge to provision for loan losses. Adjustments to impairment losses due to changes in the fair value of collateral of impaired loans are included in provision for loan losses. Upon disposition of an impaired loan, loss of principal, if any, is recorded through a charge-off to the allowance for loan losses.

In the opinion of management, and in accordance with the loan loss allowance methodology, the present allowance is considered adequate to absorb estimable and probable loan losses. Additions to the allowances are reflected in current operations. Charge-offs to the allowance are made when the loan is considered uncollectible or is transferred to real estate owned. Recoveries are credited to the allowance.

For regulatory capital purposes, the Bank's general allowance for loan losses is included to a limit of 1.25% of regulatory risk-weighted assets.

Loan Servicing

Downey services mortgage loans for investors. Fees earned for servicing loans owned by investors are reported as income when the related mortgage loan payments are collected. Loan servicing costs are charged to expense as incurred.

Investment in Real Estate and Joint Ventures

Real estate held for investment or under development is held at the lower of cost (less accumulated depreciation) or fair value. Costs, including

interest, of holding real estate in the process of development or improvement are capitalized, whereas costs relating to holding completed property are expensed. An allowance for losses is established by a charge to operations if the carrying value of a property exceeds its fair value, including the consideration of disposition costs.

Downey utilizes the equity method of accounting for investments in non-controlled joint ventures and the consolidation method for investments in controlled joint ventures. All intercompany profits are eliminated.

Income from the sale of real estate is recognized principally when title to the property has passed to the buyer, minimum down payment requirements are met and the terms of any notes received by Downey satisfy continuing investment requirements. At the time of sale, costs are relieved from real estate projects on a relative sales value basis and charged to operations.

Real Estate Acquired in Settlement of Loans

Real estate acquired through foreclosure is initially recorded at fair value (net of an allowance for estimated selling costs and delinquent property taxes) on the date of foreclosure and a writedown is recorded or a valuation allowance is established for any subsequent declines in fair value. All legal fees and direct costs, including foreclosure and other related costs, are expensed as incurred.

Premises and Equipment

Buildings, leasehold improvements and furniture, fixtures and equipment are carried at cost, less accumulated depreciation and amortization. Buildings and furniture, fixtures and equipment are depreciated using the straight-line method over the estimated useful lives of the assets. The cost of leasehold improvements is being amortized using the straight-line method over the shorter of the estimated useful life of the asset or the terms of the related leases.

Impairment of Long-Lived Assets

Downey reviews long-lived assets and certain identifiable intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceed the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

Securities Sold Under Agreements to Repurchase

Downey enters into sales of securities under agreements to repurchase ("reverse repurchase agreements"). Reverse repurchase agreements are treated as financing arrangements and, accordingly, the obligations to repurchase the securities sold are reflected as liabilities in Downey's consolidated financial statements. The securities collateralizing reverse

repurchase agreements are delivered to several major national brokerage firms who arranged the transactions. These securities are reflected as assets in Downey's consolidated financial statements. The brokerage firms may loan such securities to other parties in the normal course of their operations and agree to return the identical securities to Downey at the maturity of the agreements.

Income Taxes

Downey applies the asset and liability method of accounting for income taxes. The asset and liability method recognizes deferred income taxes for the tax consequences of "temporary differences" by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date.

Deferred tax assets are to be recognized for temporary differences that will result in deductible amounts in future years and for tax carryforwards if, in the opinion of management, it is more likely than not that the deferred tax assets will be realized.

Stock Option Plan

Downey records compensation expense on the date of grant only if the current market price of the underlying stock exceeded the exercise price rather than recognizing as expense over the vesting period the fair value of all stock-based awards on the date of grant. However, Downey provides pro forma net income and pro forma net income per share disclosures for employee stock option grants made since 1995 as if the fair-value of all stock-based awards as of the grant date are recognized as expense over the vesting period.

Per Share Information

Two earnings per share ("EPS") measures are presented. Basic EPS excludes dilution and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted from issuance of common stock that then shared in earnings.

Current Accounting Pronouncement

Statement of Financial Accounting Standards No. 140. In September 2000, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities - a replacement of FASB Statement No. 125," which revises the standards for accounting for securitizations and other transfers of financial assets and collateral and requires certain disclosures. Although it replaces FASB Statement No. 125, it carries over most of statement 125's provisions without reconsideration.

The accounting provisions are effective for fiscal years beginning after

March 15, 2001. The reclassification and disclosure provisions are effective for fiscal years beginning after December 15, 2000. It is not anticipated that the financial impact of this statement will have a material effect on Downey.

Statement of Financial Accounting Standards No. 133. In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133").

SFAS 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, (collectively referred to as derivatives) and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. If certain conditions are met, a derivative may be specifically designated as (a) a hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment, (b) a hedge of the exposure to variable cash flows of a forecasted transaction or (c) a hedge of the foreign currency exposure of a net investment in a foreign operation, an unrecognized firm commitment, an available for sale security or a foreign-currency-denominated forecasted transaction.

Under SFAS 133, an entity that elects to apply hedge accounting is required to establish at the inception of the hedge the method it will use for assessing the effectiveness of the hedging derivative and the measurement approach for determining the ineffective aspect of the hedge. Those methods must be consistent with the entity's approach to managing risk.

This statement is effective for all fiscal quarters of fiscal years beginning after June 15, 2000. It is not anticipated that the financial impact of this statement will have a material impact on Downey.

As part of secondary marketing activities, Downey utilizes forward sale and purchase derivative contracts to hedge the value of loans originated for sale against adverse changes in interest rates. At December 31, 2000, sales contracts amounted to approximately $150 million. These contracts have a high correlation to the price movement of the loans being hedged. There is no recognition of unrealized gains and losses on these contracts in the balance sheet or statement of income. When the related loans are sold, the deferred gains or losses from these contracts are recognized in the statement of income as a component of net gains or losses on sales of loans and mortgage-backed securities.

On January 1, 2001, Downey adopted SFAS 133, and at that time, designated those sales contracts as cash flow derivative instruments in accordance with the requirements of the new standard. These cash flow derivative instruments hedge the variability of forecasted cash flows attributable to interest rate risk.

Cash flow hedges are accounted for by recording the value of the derivative instrument on the balance sheet as either an asset or liability with a corresponding offset recorded in other comprehensive income within stockholders' equity, net of tax. Amounts are reclassified from other

comprehensive income to the income statement in the period the hedged cash flow occurs. Derivative gains and losses not considered effective in hedging the change in expected cash flows of the hedged item are recognized immediately in the income statement.

With the implementation of SFAS 133, Downey recorded after-tax transition amounts associated with establishing the fair values of the derivative instruments and hedged items on the balance sheet as an increase of $36,000 to net income and a reduction of $388,000 in other comprehensive income.

(In Thousands)	2001
Summary of transition adjustment at January 1:	
Balance Sheet	
Assets	
Other assets	$ 244
Deferred income tax benefit	260
	$ 504
Liabilities and Stockholders' Equity	
Accounts payable and accrued liabilities	$ 856
Accumulated other comprehensive loss - unrealized losses on derivative instruments	(388)
Retained earnings	36
	$ 504
Statement of Income	
Cumulative effect of a change in accounting principle	$ 62
Income taxes	26
Net income	$ 36

The transition adjustment will be presented as a cumulative effect adjustment as described in Accounting Principles Board Opinion No. 20, Accounting Changes, in Downey's 2001 financial statements. The transition amounts were determined based on the interpretive guidance issued to date by the Financial Accounting Standards Board. The Financial Accounting Standards Board continues to issue interpretive guidance which could require changes in Downey's application of the standard and adjustment to the transition amounts. Downey will continue to hedge as previously done; however, SFAS 133, as applied to our risk management strategies, may increase or decrease reported net income and stockholders' equity prospectively, depending on future levels of interest rates and other variables affecting the fair values of derivative instruments and hedged items, but will have no effect on cash flows or the overall economics of the transactions.

(2) Business Combination

During 1988, the Bank acquired Butterfield Savings and Loan Association, FSA ("Butterfield") from the Federal Savings and Loan Insurance Corporation ("FSLIC") in a FSLIC assisted acquisition.

Concurrent with the acquisition, the Bank and the FSLIC entered into an assistance agreement ("Butterfield Assistance Agreement") that provides for

the indemnification of the Bank against losses incurred on the disposal of certain defined covered assets and the settlement of certain unreserved preacquisition liabilities or contingencies reduced by tax benefits associated with those expenses as defined. Additionally, the FSLIC agreed to provide yield maintenance assistance on certain covered assets at the Federal Home

Loan Bank ("FHLB") Eleventh District Cost of Funds Index ("COFI"). All such amounts received are nontaxable under the Internal Revenue Code.

All assets subject to the Butterfield Assistance Agreement were sold or repurchased by the Federal Deposit Insurance Corporation ("FDIC") on December 29, 1995. By its terms, the Butterfield Assistance Agreement terminated on March 31, 1997.

The Butterfield Assistance Agreement provides broad authority to the FDIC to conduct audits. A compliance audit was completed by the FDIC for the period July 1, 1993 to June 30, 1996. A final post termination audit of the Butterfield Assistance Agreement by the FDIC remains to be completed.

(3) U.S. Treasury Securities, Agency Obligations and Other Investment Securities Available for Sale

The amortized cost and estimated market value of U.S. Treasury securities, agency obligations and other investment securities available for sale are summarized as follows:

(In Thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
U.S. Treasury and agency securities	$283,132	$ 1,069	$ 99	$284,102
Corporate securities	21,212	301	--	21,513
December 31, 2000	$304,344	$ 1,370	$ 99	$305,615
U.S. Treasury and agency securities at December 31, 1999	$174,223	$ --	$ 2,400	$171,823

At December 31, 2000, $283 million in amortized cost and $284 million in estimated market value of these investment securities contain call provisions. The call dates range from January 5, 2001 to June 2, 2002.

The amortized cost and estimated market value of U.S. Treasury securities, agency obligations and other investment securities available for sale at December 31, 2000, by contractual maturity, are shown below.

Amortized Market

(In Thousands)	Cost	Value
Due in one year or less	$ 5,000	$ 5,008
Due after one year through five years (1)	299,344	300,607
Total	$304,344	$305,615

Proceeds, gross realized gains and losses on the sales of U.S. Treasury securities, agency obligations and other investment securities available for sale are summarized as follows:

(In Thousands)	2000	1999	1998
Proceeds	$29,645	$67,195	$60,319
Gross realized gains	$ 4	$ 288	$ 68
Gross realized losses	$ 110	$ --	$ --

Net unrealized gains on investment securities available for sale were recognized in stockholders' equity as accumulated other comprehensive income in the amount of $1.3 million, or $0.7 million net of income

taxes, at December 31, 2000, compared to net unrealized losses of $2.4 million, or $1.4 million net of income taxes, at December 31, 1999.

(4) Loans and Mortgage-Backed Securities Purchased Under Resale Agreements and Other Investment Securities Held to Maturity

Loans and Mortgage-Backed Securities Purchased Under Resale Agreements

There were no outstanding loans or mortgage-backed securities purchased under resale agreements at December 31, 2000 or 1999. The average interest rate and balance of such transactions was 6.70% and $3 million, respectively, during 2000 and 5.16% and $4 million, respectively, during 1999. There was no amount outstanding at any month-end during 2000 and 1999.

Municipal Securities Held to Maturity

The amortized cost and estimated market value of municipal securities held to maturity are summarized as follows:

Gross	Gross	Estimated

(In Thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Market Value
December 31, 2000	$6,550	$ --	$ 16	$6,534
December 31, 1999	$6,728	$ --	$ 18	$6,710

All of the investment at December 31, 2000 and all but $30,000 of the investment in 1999 represents an industrial revenue bond on which the interest income is not subject to federal income taxes and matures in 2015.

(5) Mortgage-Backed Securities Available for Sale

The amortized cost and estimated market value of the mortgage-backed securities available for sale are summarized as follows:

(In Thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
December 31, 2000:				
FHLMC certificates	$ 4,182	$ --	$ 29	$ 4,153
Non-agency certificates	6,086	6	42	6,050
Total	$10,268	$ 6	$ 71	$10,203
December 31, 1999:				
GNMA certificates	$ 5,112	$ 100	$ 1	$ 5,211
FNMA certificates	125	3	--	128
FHLMC certificates	8,936	--	257	8,679
Non-agency certificates	7,897	10	206	7,701
Total	$22,070	$ 113	$ 464	$21,719

Net unrealized losses on mortgage-backed securities available for sale were recognized in stockholders' equity as accumulated other comprehensive income in the amount of $65,000, or $37,000 net of income taxes, at December 31, 2000. At December 31, 1999, net unrealized losses were recognized in

stockholders' equity as accumulated other comprehensive income in the amount of $350,000, or $202,000 net of income taxes.

Proceeds, gross realized gains and losses on the sales of mortgage-backed securities available for sale are summarized as follows:

(In Thousands)	2000	1999	1998
Proceeds	$ 963,712	$1,386,151	$ 608,158
Gross realized gains	$ 4,788	$ 14,017	$ 3,490
Gross realized losses	$ 5,690	$ 2,504	$ 3,814

(6) Loans Receivable

Loans receivable are summarized as follows:

	December 31,	
(In Thousands)	2000	1999
Held for investment:		
Loans secured by real estate:		
Residential:		
One-to-four units	$ 7,655,238	$ 6,155,399
One-to-four units - subprime	1,743,914	1,639,401
Five or more units	19,460	21,055
Commercial real estate	164,604	148,327
Construction	118,165	176,487
Land	26,880	67,631
Non-mortgage:		
Commercial	21,721	26,667
Automobile	39,614	399,789
Other consumer	60,653	49,344
Total loans receivable held for investment	9,850,249	8,684,100
Less:		
Undisbursed loan funds	(72,328)	(125,159)
Net deferred costs and premiums	79,109	67,740
Allowance for estimated losses	(34,452)	(38,342)
Total loans receivable held for investment, net	$ 9,822,578	$ 8,588,339
Held for sale:		
Loans secured by residential one-to-four units	$ 251,572	$ 136,005

Over 93% of the real estate securing Downey's loans is located in California.

A summary of activity in the allowance for loan losses for loans receivable held for investment during 2000, 1999 and 1998 follows:

(In Thousands)	Real Estate	Commercial	Automobile	Other Consumer	Spec Al
Balance at December 31, 1997	$ 20,256	$ 196	$ 8,016	$ 824	$
Provision for (reduction of) loan losses	(1,480)	22	5,287	70	
Charge-offs	(1,103)	--	(6,118)	(151)	
Recoveries	1,735	--	1,159	4	
Balance at December 31, 1998	19,408	218	8,344	747	
Provision for loan losses	9,252	116	1,879	23	
Charge-offs	(580)	--	(4,795)	(160)	
Recoveries	250	--	831	9	
Balance at December 31, 1999	28,330	334	6,259	619	
Provision for loan losses	2,350	108	517	276	
Charge-offs	(735)	--	(832)	(182)	
Recoveries	269	--	136	14	
Transfers (1)	--	--	(5,811)	--	
Balance at December 31, 2000	$ 30,214	$ 442	$ 269	$ 727	$

Net charge-offs represented 0.01%, 0.06% and 0.08% of average loans for 2000, 1999 and 1998, respectively.

All impaired loans at December 31, 2000 and 1999 were secured by commercial real estate. The following table presents impaired loans with specific allowances and the amount of such allowances and impaired loans without specific allowances.

(In Thousands)	Net Carrying Value	Specific Allowance	Net Balance
December 31, 2000:			
Loans with specific allowances ..	$ --	$ --	$ --
Loans without specific allowances	13,841	--	13,841
Total impaired loans	$13,841	$ --	$13,841
December 31, 1999:			
Loans with specific allowances ..	$ --	$ --	$ --
Loans without specific allowances	13,049	--	13,049
Total impaired loans	$13,049	$ --	$13,049

The average recorded investment in impaired loans totaled $13 million in both 2000 and 1999. During 2000, total interest recognized on the impaired loan portfolio was $2.9 million, compared to $1.9 million in 1999 and $2.0 million in 1998.

The combined weighted average interest yield on loans receivable held for investment and sale was 8.45% and 7.67% as of December 31, 2000 and 1999, respectively, and averaged 7.99%, 7.48% and 7.89% during 2000, 1999 and 1998, respectively.

The aggregate amount of non-accrual loans receivable that are contractually past due 90 days or more as to principal or interest, in the foreclosure process, restructured, or upon which interest collection is doubtful were $45 million and $33 million as of December 31, 2000 and 1999, respectively. At December 31, 2000 we had less than $1 million of troubled debt restructurings on accrual status representing a single one-to-four unit residential loan.

Interest due on non-accrual loans, but excluded from interest income, was approximately $1.8 million for 2000, $1.1 million for 1999 and $0.5 million for 1998.

Downey has had, and expects in the future to have, transactions in the ordinary course of business with executive officers, directors and their associates ("related parties") on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other non-related parties. In the opinion of management, those transactions neither involve more than the normal risk of collectibility nor present any unfavorable features. At December 31, 2000, the Bank had extended loans to two of its directors and their associates totaling $23 million. At December 31, 1999, the Bank had extended loans to one director and his associates totaling $27 million. All such loans are performing in accordance with their loan terms. Presented below is a summary of activity with respect to such loans for the years ending December 31, 2000 and 1999:

(In Thousands)	2000	1999
Balance at beginning of period	$ 26,657	$ 25,763
Additions	632	4,149
Repayments	(4,222)	(3,255)
Balance at end of period	$ 23,067	$ 26,657

(7) Investments in Real Estate and Joint Ventures

Investments in real estate and joint ventures are summarized as follows:

(In Thousands)	December 31, 2000	1999
Gross investments in real estate (1)	$ 23,948	$ 46,715

Accumulated depreciation	(7,313)	(7,127)
Allowance for estimated losses	(1,492)	(2,131)
Investments in real estate	15,143	37,457
Investments in and interest bearing advances to joint ventures	4,003	4,715
Joint venture valuation allowance	(1,505)	--
Investments in joint ventures	2,498	4,715
Total investments in real estate and joint ventures	$ 17,641	$ 42,172

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DOWNEY FINANCIAL CORP. AND SUBSIDIARIES
Notes to Consolidated Financial Statements----(Continued)

The table set forth below describes the type, location and amount invested in real estate and joint ventures, net of specific valuation allowances of $3 million and general valuation allowances of less than $1 million, at December 31, 2000:

(In Thousands)	California	Arizona	Other	
Shopping centers	$ 1,916	$ 6,351	$ --	$
Office buildings	702	--	--	
Residential	3,063	--	--	
Land	5,524	109	459	
Total real estate before general valuation allowance	$ 11,205	$ 6,460	$ 459	
General valuation allowance				
Net investment in real estate and joint ventures				$

A summary of real estate and joint venture operations included in Downey's results of operations follows:

(In Thousands)	2000	1999	1
Wholly owned operations:			
Rental operations:			
Rental income	$ 3,617	$ 4,950	$ 5
Costs and expenses	(1,045)	(1,128)	(1
Net rental operations	2,572	3,822	3
Net gains on sales of real estate	2,981	5,206	2
Reduction of losses on real estate	639	2,266	5
Total wholly owned operations	6,192	11,294	11

Joint venture operations:			
Equity in net income from joint ventures	3,224	5,352	9
Reduction of (provision for) losses provided by DSL Service Company	(1,505)	1,400	
Net joint venture operations	1,719	6,752	9
Interest from joint venture advances	887	1,256	1
Total joint venture operations	2,606	8,008	11
Total	$ 8,798	$ 19,302	$ 22

Activity in the allowance for losses on real estate and investments in joint ventures for 2000, 1999 and 1998 is as follows:

(In Thousands)	Real Estate Held for or Under Development	Commercial Real Estate Held for Investment	Residential Real Estate Held for Investment	Invest In Jo Ventu
Balance at December 31, 1997	$ 5,829	$ 2,021	$ 11,767	$ 1,
Provision for (reduction of) estimated losses	33	(427)	(4,687)	(
Charge-offs	(1,151)	--	(7,080)	-
Recoveries	--	--	--	-
Balance at December 31, 1998	4,711	1,594	--	1,
Reduction of estimated losses	(1,741)	(525)	--	(1,
Charge-offs	(1,908)	--	--	
Recoveries	--	--	--	-
Balance at December 31, 1999	1,062	1,069	--	-
Provision for (reduction of) estimated losses	--	(639)	--	1,
Charge-offs	--	--	--	-
Recoveries	--	--	--	-
Balance at December 31, 2000	$ 1,062	$ 430	$ --	$ 1,

Condensed financial information of joint ventures reported on the equity method is as follows:

Condensed Combined Balance Sheets - Joint Ventures

(In Thousands)	December 31, 2000	1999
Assets		
Cash	$ 2,182	$ 1,870
Projects under development	6,879	12,523
Completed projects	20,468	25,155
Other assets	1,474	2,903
	$ 31,003	$ 42,451
Liabilities and Equity		
Liabilities:		
Notes payable to the Bank	$ 23,398	$ 34,697
Notes payable to others	4,282	3,230
Other	4,755	6,175
Equity (deficit):		
DSL Service Company (1)	2,498	4,715
Allowance for losses recorded by DSL Service Company (2)	1,505	--
Other partners' (2)	(5,435)	(6,366)
Net deficit	(1,432)	(1,651)
	$ 31,003	$ 42,451

Condensed Combined Statements of Operations - Joint Ventures

(In Thousands)	2000	1999	1998
Real estate sales:			
Sales	$ 32,237	$ 40,096	$ 59,095
Cost of sales	(26,021)	(31,770)	(39,261)
Net gains on sales	6,216	8,326	19,834
Rental operations:			
Rental income	3,849	5,825	6,252
Operating expenses	(901)	(2,192)	(2,409)
Interest, depreciation and other expenses	(3,131)	(4,236)	(5,271)
Net loss on rental operations	(183)	(603)	(1,428)
Net income	6,033	7,723	18,406
Less other partners' share of net income	2,809	2,371	9,203

DSL Service Company's share of net income	3,224	5,352	9,203
Reduction of (provision for) losses provided by DSL Service Company	(1,505)	1,400	215
DSL Service Company's share of net income	$ 1,719	$ 6,752	$ 9,418

(8) Real Estate Acquired in Settlement of Loans

Real estate acquired in settlement of loans is recorded at the lower of cost or fair value on an individual asset basis.

The type and amount of real estate acquired in settlement of loans is summarized as follows:

	December 31,	
(In Thousands)	2000	1999
Residential one-to-four units	$6,651	$4,973
Residential one-to-four units - subprime	3,291	926
Total real estate acquired in settlement of loans	$9,942	$5,899

A summary of net operation of real estate acquired in settlement of loans included in Downey's results of operations follows:

(In Thousands)	2000	1999	19
Net gains on sales	$ (669)	$ (704)	$(1,
Net operating expense	1,075	768	1,
Provision for (reduction of) estimated losses	412	(45)	
Net operations of real estate acquired in settlement of loans	$ 818	$ 19	$

Activity in the allowance for estimated losses on real estate acquired through foreclosure for 2000, 1999 and 1998 is as follows:

(In Thousands)	2000	1999	1998

Balance at beginning of period	$--	$ 533	$ 839
Provision for (reduction of) real estate losses	412	(45)	455
Charge-offs	(442)	(488)	(761)
Recoveries	30	--	--
Balance at end of period	$--	$--	$ 533

(9) Premises and Equipment

Premises and equipment are summarized as follows:

	December 31,	
(In Thousands)	2000	1999
Land	$ 24,626	$ 23,653
Building and improvements	91,361	90,591
Furniture, fixtures and equipment	67,331	64,693
Construction in progress	769	18
Other	62	62
Total premises and equipment	184,149	179,017
Accumulated depreciation and amortization	(79,971)	(71,039)
Total premises and equipment, net	$ 104,178	$ 107,978

Downey has commitments under long term operating leases, principally for building space and land. Lease terms generally cover a five-year period. Rental expense was $2.3 million in 2000, $2.1 million in 1999 and $1.7 million in 1998. The following table summarizes future minimum rental commitments under noncancelable leases.

(In Thousands)	
2001	$2,247
2002	1,725
2003	1,264
2004	588
2005	646
Thereafter (1)	769
Total future lease commitments	$7,239

(10) Federal Home Loan Bank Stock

The Bank's required investment in FHLB stock, based on December 31, 2000 financial data, was $99 million. The investment in FHLB stock amounted to $106 million and $102 million at December 31, 2000 and 1999, respectively.

(11) Mortgage Servicing Rights

Mortgage loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of mortgage loans serviced for others was $4.0 billion at December 31, 2000 and $2.9 billion at December 31, 1999.

Custodial escrow balances maintained in connection with the foregoing loan servicing, and included in demand deposits, were $8 million and $5 million at December 31, 2000 and 1999, respectively.

A summary of activity in mortgage servicing rights and the allowance for mortgage servicing rights during 2000, 1999 and 1998 as well as the estimated fair value of mortgage servicing rights at each period end are as follows:

(In Thousands)	2000	1999	1998
Gross balance at beginning of period ...	$ 34,266	$ 8,256	$ 2,161
Additions	18,510	29,271	7,276
Amortization	(5,968)	(3,051)	(653)
Sale of servicing	--	--	(17)
Impairment write-down	(594)	(210)	(511)
Gross balance at end of period	46,214	34,266	8,256
Allowance balance at beginning of period	3	464	206
Provision for (reduction of) impairment	6,074	(251)	769
Impairment write-down	(594)	(210)	(511)
Allowance balance at end of period ..	5,483	3	464
Mortgage servicing rights, net	$ 40,731	$ 34,263	$ 7,792
Estimated fair value (1)	$ 41,826	$ 37,048	$ 7,844

The unpaid principal balances of mortgage loans serviced for others with capitalized mortgage servicing rights was $3.8 billion at December 31, 2000 and $2.7 billion at December 31, 1999. The weighted average interest rate on the associated loans was 7.56% at December 31, 2000 and 7.23% at December 31, 1999.

The components of loan servicing fees included in Downey's results of operations are summarized as follows:

(In Thousands)	2000	1999	1998

Income from servicing operations	$ 8,414	$ 4,472	$ 1,681
Amortization of MSRs	(5,968)	(3,051)	(653)
(Provision for) reduction of impairment	(6,074)	251	(769)
Loan servicing fees	$(3,628)	$ 1,672	$ 259

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DOWNEY FINANCIAL CORP. AND SUBSIDIARIES
Notes to Consolidated Financial Statements----(Continued)

(12) Other Assets

Other assets are summarized as follows:

	December 31,	
(In Thousands)	2000	1999
Accounts receivable	$ 2,406	$ 3,338
Accrued interest receivable:		
Loans	61,131	43,240
Mortgage-backed securities	60	123
Investment securities	6,206	3,360
Prepaid expenses	14,210	12,362
Excess of purchase price over fair value of assets acquired and liabilities assumed, net	3,608	4,070
Repossessed automobiles, net	76	314
Other	2,997	2,268
Total other assets	$90,694	$69,075

(13) Deposits

Deposits are summarized as follows:

	December 31,			
	2000		1999	
(Dollars in Thousands)	Weighted Average Rate	Amount	Weighted Average Rate	Amount
Transaction accounts:				
Non-interest-bearing checking .	-%	$ 244,311	-%	$ 182,165
Interest-bearing checking (1) .	0.78	395,640	1.00	383,973
Money market	2.88	89,408	2.91	95,947
Regular passbook	3.41	754,127	3.62	827,854

Total transaction accounts .	2.12	1,483,486	2.46	1,489,939
Certificates of deposit:				
Less than 3.00%	2.41	6,357	2.47	8,717
3.00-3.49	3.45	25	3.02	16
3.50-3.99	3.97	384	3.92	3,786
4.00-4.49	4.19	26,916	4.32	210,127
4.50-4.99	4.82	80,844	4.78	939,858
5.00-5.99	5.71	1,901,166	5.56	3,623,632
6.00-6.99	6.63	4,558,730	6.07	284,984
7.00 and greater	7.02	24,781	7.32	1,702
Total certificates of deposit	6.33	6,599,203	5.39	5,072,822
Total deposits	5.56%	$8,082,689	4.72%	$6,562,761

The aggregate amount of jumbo certificates of deposit with a minimum denomination of $100,000 was $2.3 billion and $1.7 billion at December 31, 2000 and 1999, respectively.

At December 31, 2000, scheduled maturities of certificates of deposit are as follows:

(Dollars in Thousands)	Weighted Average Rate	Amount
2001	6.34%	$5,955,136
2002	6.30	614,832
2003	5.57	19,689
2004	5.43	4,746
2005	6.10	4,800
Thereafter	-	--
Total	6.33%	$6,599,203

The weighted average cost of deposits averaged 5.20%, 4.51% and 4.87% during 2000, 1999 and 1998, respectively.

As of December 31, 2000 and 1999 public funds of approximately $5 million and $3 million, respectively, are secured by mortgage loans with a carrying value of approximately $7 million and $5 million at December 31, 2000 and 1999, respectively.

Interest expense on deposits by type is summarized as follows:

(In Thousands)	2000	1999	1998
Interest-bearing checking (1) ..	$ 3,520	$ 3,517	$ 3,142
Money market	2,544	2,641	2,626
Regular passbook	27,841	26,224	17,102
Certificate accounts	345,398	224,382	225,467
Total deposit interest expense	$379,303	$256,764	$248,337

Accrued interest on deposits, which is included in accounts payable and accrued liabilities, was $3 million at December 31, 2000 and $2 million at December 31, 1999.

(14) Securities Sold Under Agreements to Repurchase

Securities sold under agreements to repurchase are summarized as follows:

(Dollars in Thousands)	2000	1999	1998
Balance at year end	$ --	$ --	$ --
Average balance outstanding during the year	753	1,987	1,877
Maximum amount outstanding at any month-end during the year	39,250	24,875	50,088
Weighted average interest rate during the year	6.10%	5.42%	5.90%
Weighted average interest rate at year end	-	-	-

The securities collateralizing these transactions were delivered to major national brokerage firms who arranged the transactions. Securities sold under agreements to repurchase generally mature within 30 days of the various dates of sale.

(15) Federal Home Loan Bank Advances

FHLB advances are summarized as follows:

(Dollars in Thousands)	2000	1999	
Balance at year end	$1,978,348	$2,122,407	$
Average balance outstanding during the year	2,117,787	1,169,474	
Maximum amount outstanding at any month-end during the year	2,460,276	2,122,407	
Weighted average interest rate during the year	6.15%	5.44%	
Weighted average interest rate at year end	6.26	5.77	
As of year end secured by:			
Loans receivable	$2,222,863	$2,395,599	$

In addition to the collateral securing existing advances, Downey had an additional $779 million in loans available as collateral for any future advances as of December 31, 2000.

FHLB advances have the following maturities at December 31, 2000:

(In Thousands)	
2001	$1,491,293
2002	55,921
2003	134
2004	--
2005	1,000
Thereafter	430,000
Total ..	$1,978,348

(16) Commercial Paper

Commercial paper borrowings are summarized as follows:

(Dollars in Thousands)	2000	1999	1998
Balance at year end	$ --	$ --	$ --
Average balance outstanding during the year	--	--	30,589
Maximum amount outstanding at any month-end during the year	--	--	103,749
Weighted average interest rate during the year	-%	-%	6.32%
Weighted average interest rate at end of year	-	-	-

The commercial paper program was discontinued during 1998.

(17) Other Borrowings

Other borrowings are summarized as follows:

	December 31,	
(Dollars In Thousands)	2000	1999

Long-term notes payable to banks, secured by real estate and mortgage loans with a carrying value of $669 at December 31, 2000, bearing interest rates of 7.88% to 9.88%	$224	$373

Other borrowings have the following maturities at December 31, 2000:

(In Thousands)	
2001	$ 186
2002	7
2003	--
2004	--
2005	--
Thereafter	31
Total ..	$ 224

(18) Income Taxes

Current income taxes payable were $4 million and $12 million at December 31, 2000 and 1999, respectively.

Deferred tax liabilities (assets) are comprised of the following temporary differences between the financial statement carrying amounts and the tax basis of assets:

	December 31,	
(In Thousands)	2000	1999
Deferred tax liabilities:		
Tax reserves in excess of base year	$ 22,115	$ 21,904
Mortgage servicing rights, net of allowances	17,783	14,818
FHLB stock dividends	11,588	8,197
Deferred loan fees	6,882	5,344
Depreciation on premises and equipment	2,093	2,737
Equity in joint ventures	1,724	--
Unrealized gains on investment securities	519	--
Total deferred tax liabilities	62,704	53,000
Deferred tax assets:		
Loan valuation allowances, net of bad debt charge-offs	(16,172)	(18,017)
California franchise tax	(5,651)	(3,959)
Real estate and joint venture valuation allowances ...	(2,734)	(2,180)

Deferred compensation	(2,289)	(1,895)
Other deferred income items	(2,056)	(1,217)
Unrealized losses on investment securities	--	(1,183)
Mark to market adjustment on loans held for sale	(72)	(357)
Equity in joint ventures	--	(293)
Total deferred tax assets	(28,974)	(29,101)
Deferred tax assets valuation allowance	--	--
Net deferred tax liability	$ 33,730	$ 23,899

Income taxes (benefits) are summarized as follows:

(In Thousands)	2000	1999	1998
Federal:			
Current	$ 48,714	$ 18,382	$ 38,474
Deferred	5,567	19,821	(5,848)
Total federal income taxes	$ 54,281	$ 38,203	$ 32,626
State:			
Current	$ 16,214	$ 8,186	$ 10,955
Deferred	2,563	418	(413)
Total state income taxes	$ 18,777	$ 8,604	$ 10,542
Total:			
Current	$ 64,928	$ 26,568	$ 49,429
Deferred	8,130	20,239	(6,261)
Total income taxes	$ 73,058	$ 46,807	$ 43,168

A reconciliation of income taxes (benefits) to the expected statutory federal corporate income taxes follows:

	2000		1999	
(Dollars in Thousands)	Amount	Percent	Amount	Percent
Expected statutory income taxes	$ 60,308	35.0%	$ 38,714	35.0%
California franchise tax, net of federal income tax benefit	12,206	7.1	7,606	6.9
Increase (decrease) resulting from:				

Amortization of goodwill	162	0.1	166	0.2
Interest on municipal bonds	(99)	(0.1)	(105)	(0.1)
Other	481	0.3	426	0.3
Income taxes	$ 73,058	42.4%	$ 46,807	42.3%

Downey made income tax payments, net of refunds, amounting to $73.7 million, $22.1 million and $52.8 million in 2000, 1999 and 1998, respectively.

Downey and its wholly owned subsidiaries file a consolidated federal income tax return and various state income and franchise tax returns on a calendar year basis. The Internal Revenue Service and state taxing authorities have examined Downey's tax returns for all tax years through 1995 and are currently reviewing returns filed for the 1996 tax year. Downey made a payment of $10.7 million during the year to settle federal tax claims related to the sale and leaseback of computer equipment in 1990. This amount had been previously reflected in Downey's tax accrual, and therefore had no adverse impact upon current year earnings. In addition, Downey's management believes it has adequately provided for potential exposure with regard to other tax issues in the years currently under examination. Tax years subsequent to 1996 remain open to review by federal and state tax authorities.

(19) Capital Securities

On July 23, 1999, Downey, through Downey Financial Capital Trust I (the "Trust"), issued $120 million in 10.00% capital securities. The capital securities, which were sold in a public underwritten offering, pay quarterly cumulative cash distributions at an annual rate of 10.00% of the liquidation value of $25 per share and are recorded as interest expense by Downey. The capital securities represent undivided beneficial interests in the Trust, which was established by Downey for the purpose of issuing the capital securities. Downey owns all of the issued and outstanding common securities of the Trust. Proceeds from the offering and from the issuance of common securities were invested by the Trust in 10.00% Junior Subordinated Deferrable Interest Debentures due September 15, 2029 issued by Downey (the "Junior Subordinated Debentures"), with an aggregate principal amount of $124 million. The sole asset of the Trust is the Junior Subordinated Debentures. The obligations of the Trust with respect to the securities are fully and unconditionally guaranteed by Downey. The payment of distributions on the capital securities may be deferred if Downey defers payments of interest on the junior subordinated debentures. Downey will have the right, on one or more occasions, to defer payments of interest on the junior subordinated debentures for up to 20 consecutive quarterly periods. During the time Downey defers interest payments, interest on the junior subordinated debentures will continue to accrue and distributions on the capital securities will continue to accumulate and the deferred interest and deferred distributions will themselves accrue interest at an annual rate of 10.00%, compounded quarterly, to the extent permitted by applicable law. Downey may redeem, in whole or in part, the junior subordinated debentures before their maturity at a redemption price of 100% of their principal amount plus accrued and unpaid interest on or after July

23, 2004.

Downey invested $108 million of the $115 million of net proceeds from the sale of the Junior Subordinated Debentures (net of underwriting discounts and commissions and other offering expenses) as additional common stock of the Bank thereby increasing the Bank's regulatory core / tangible capital by that amount. The balance of the net proceeds have been used for general corporate purposes.

(20) Stockholders' Equity

Regulatory Capital

Downey is not subject to any regulatory capital requirements. However, the Bank is subject to regulation by the Office of Thrift Supervision ("OTS") which has adopted regulations ("Capital Regulations") that contain a capital standard for savings institutions. The Bank is in compliance with the Capital Regulations at December 31, 2000 and 1999.

	Actual		For Capital Adequacy Purposes		Ca Pr Ac
(Dollars in Thousands)	Amount	Ratio	Amount	Ratio	A
2000					
Risk-based capital (to risk-weighted assets)	$731,844	12.94%	$452,480	8.00%	$5
Core capital (to adjusted assets)	697,715	6.42	325,791	3.00	5
Tangible capital (to adjusted assets)	697,715	6.42	162,896	1.50	
Tier I capital (to risk-weighted assets)	697,715	12.34	--	- (1)	3
1999					
Risk-based capital (to risk-weighted assets)	$623,863	12.14%	$410,955	8.00%	$5
Core capital (to adjusted assets)	585,909	6.27	280,382	3.00	4
Tangible capital (to adjusted assets)	585,909	6.27	140,191	1.50	
Tier I capital (to risk-weighted assets)	585,909	11.41	--	- (1)	3

Capital Distributions

The OTS rules impose certain limitations regarding stock repurchases and

redemptions, cash-out mergers and any other distributions charged against an institution's capital accounts. The payment of dividends by the Bank is subject to OTS regulations. Inasmuch as the Bank is owned by a holding company, the Bank is required to provide the OTS with a notice before payment of any dividend. Prior OTS approval is required, however, to the extent the Bank would not be considered adequately capitalized under the prompt corrective action regulations of the OTS following the distribution or the amount of the dividend exceeds the Bank's retained net income for that year to date plus retained net income for the preceding two years.

As of December 31, 2000, the Bank had the capacity to declare a dividend totaling $193 million without obtaining prior OTS approval.

Stock Dividend

On April 22, 1998, the Board of Directors declared a five percent stock dividend on Downey's common stock payable on May 22, 1998 to stockholders of record on May 7, 1998. The stock dividend resulted in the issuance of 1,337,271 shares and the par value of the common stock remained at $0.01. Accordingly,

$13,000 and $45.7 million were transferred from retained earnings to common stock and additional paid-in-capital, respectively. All share and per share data, including stock option plan information, have been restated to reflect this distribution.

Employee Stock Option Plans

During 1994, the Bank adopted and the stockholders approved the Downey Savings and Loan Association 1994 Long Term Incentive Plan (the "LTIP"). The LTIP provides for the granting of stock appreciation rights, restricted stock, performance awards and other awards. The LTIP specifies an authorization of 434,110 shares (adjusted for stock dividends and splits) of the Bank's common stock available for issuance under the LTIP. Effective January 23, 1995, Downey Financial Corp. and the Bank executed an amendment to the LTIP by which Downey Financial Corp. adopted and ratified the LTIP such that shares of Downey Financial Corp. shall be issued upon exercise of options or payment of other awards, for which payment is to be made in stock, in lieu of the Bank's common stock.

During 2000 and 1999, no shares were granted under the LTIP, while in 1998, 120,335 shares were granted.

Options outstanding under the LTIP at December 31, 2000 and 1999 are summarized as follows:

	Outstanding Options	
	Number of Shares	Average Option Price

December 31, 1997	143,886	$ 13.40
Options granted .	120,335	25.44
Options exercised	(38,567)	13.26
Options canceled	(6,203)	13.39
December 31, 1998	219,451	20.03
Options granted .	--	--
Options exercised	(16,633)	13.16
Options canceled	(2,068)	13.39
December 31, 1999	200,750	20.66
Options granted .	--	--
Options exercised	(57,332)	14.91
Options canceled	--	--
December 31, 2000	143,418	$ 22.96

Under the LTIP, options are exercisable over vesting periods specified in each grant and, unless exercised, the options terminate between five or ten years from the date of the grant. Further, under the LTIP, the option price shall at least equal or exceed the fair market value of such shares on the date the options are granted.

At December 31, 2000, 143,418 were outstanding at a weighted average remaining contractual life of six years, of which 71,214 options were exercisable at a weighted average option price per share of $20.45 and 127,722 shares were available for future grants under the LTIP. At December 31, 1999 and 1998, options of 100,344 and 78,439, respectively, were exercisable at a weighted average option price per share of $16.30 and $13.26, respectively.

Downey measures its employee stock-based compensation arrangements under the provisions of APB 25. Accordingly, no compensation expense has been recognized for the stock option plan. Had compensation expense for Downey's stock option plan been determined based on the fair value at the grant date for

previous awards, Downey's net income and income per share would have been reduced to the pro forma amounts indicated below:

(In Thousands, Except Per Share Data)	2000	1999	1998
Net income:			
As reported	$99,251	$63,804	$57,973
Pro forma	99,172	63,611	57,954
Earnings per share - Basic:			
As reported	$3.52	$2.27	$2.06
Pro forma	3.52	2.26	2.06

Earnings per share - Diluted:			
As reported	3.51	2.26	2.05
Pro forma	3.51	2.26	2.05

The weighted average fair value at date of grant of options granted was $7.77 during 1998. The fair value of options at date of grant was estimated using the Black-Scholes model with the following weighted average assumptions:

	2000 (1)	1999 (1)	1998
Expected life (years)	-	-	3.11
Interest rate	-%	-%	4.65%
Volatility	-	-	40.31
Dividend yield	-	-	1.23

(21) Earnings Per Share

A reconciliation of the components used to derive basic and diluted earnings per share for 2000, 1999 and 1998 follows:

(Dollars in Thousands, Except Per Share Data)	Net Income	Weighted Average Shares Outstanding	Per Share Amount
2000:			
Basic earnings per share	$99,251	28,177,152	$3.52
Effect of dilutive stock options	--	48,399	0.01
Diluted earnings per share	$99,251	28,225,551	$3.51
1999:			
Basic earnings per share	$63,804	28,144,851	$2.27
Effect of dilutive stock options	--	30,686	0.01
Diluted earnings per share	$63,804	28,175,537	$2.26
1998:			
Basic earnings per share	$57,973	28,111,855	$2.06
Effect of dilutive stock options	--	64,388	0.01
Diluted earnings per share	$57,973	28,176,243	$2.05

(22) Employee Benefit Plans

Retirement and Savings Plan

In August 1993, Downey amended its profit sharing plan so that it qualifies as a profit sharing and savings plan under Section 401(k) of the Internal Revenue Code (the "Plan"), covering substantially all salaried employees. Under the Plan, employee contributions are partially matched by Downey. Downey's matching contribution is equal to 25% of an employee's pretax contributions which do not exceed 4% of the employee's annual compensation. In addition, Downey makes an annual retirement contribution based on Downey's net income and the employee's age, vested years of service and salary. Downey's contributions to the Plan totaled $2.0 million for 2000, compared to $1.9 million in both 1999 and 1998.

During 1995, Downey approved the implementation of a Deferred Compensation Plan for key management employees and directors. The Deferred Compensation Plan is considered to be an essential element in a comprehensive competitive benefits package designed to attract and retain individuals who contribute to the success of Downey. Participants are eligible to defer compensation on a pre-tax basis, including director fees, and earn a competitive interest rate on the amounts deferred. Currently, 66 management employees and seven directors are eligible to participate in the program. During 2000, 23 management employees and one director elected to defer compensation pursuant to the plan. Downey's expense related to the Deferred Compensation Plan has been less than $0.1 million each year since inception.

Group Benefit Plan

Downey provides certain health and welfare benefits for active employees under a cafeteria plan (the "Benefit Plan") as defined by section 125 of the Internal Revenue Code. Under the Benefit Plan, employees make appropriate selections as to the type of benefits and the amount of coverage desired. The benefits are provided through insurance companies and other health organizations and are funded by contributions from Downey, employees and retirees and include deductibles, co-insurance provisions and other limitations. Downey's expense for health and welfare benefits was $3.9 million, $3.6 million and $3.1 million in 2000, 1999 and 1998, respectively.

(23) Commitments and Contingencies

Litigation

Downey has been named as a defendant in legal actions arising in the ordinary course of business, none of which, in the opinion of management, is material.

Financial Instruments with Off-Balance-Sheet Risk

Downey is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to originate fixed and variable rate mortgage loans, commitments to sell or purchase loans and mortgage-backed securities, letters of credit, lines of credit and loans in process. The contract or notional amounts of those instruments reflect the extent of involvement Downey has in particular classes of financial instruments.

Downey uses the same credit policies in making commitments to originate

loans, lines of credit and letters of credit as it does for on-balance-sheet instruments. For commitments to originate fixed rate loans, the contract amounts represent exposure to loss from market fluctuations as well as credit loss. To hedge adverse changes from market fluctuations, Downey utilizes forward sale and purchase derivative contracts that mature in less than one year. Downey controls the credit risk of its commitments to originate fixed rate loans through credit approvals, limits and monitoring procedures.

The following is a summary of commitments and contingent liabilities:

	December 31,	
(In Thousands)	2000	1999
Commitments to sell loans and mortgage-backed securities ...	$149,898	$210,092
Commitments to purchase investment securities	--	15,000
Commitments to purchase loans and mortgage-backed securities	--	13,992
Commitments to originate loans:		
Adjustable	454,782	422,145
Fixed	239,415	184,695
Undisbursed loan funds and unused lines of credit	148,304	209,414
Standby letters of credit and other contingent liabilities .	2,446	2,423

Commitments to sell or purchase loans and mortgage-backed securities are used as part of Downey's secondary marketing activities. These contracts have a high correlation to the price movement on loans which provides a hedge against adverse changes in interest rates.

Commitments to originate fixed and variable rate mortgage loans are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The credit risk involved in issuing lines and letters of credit requires the same creditworthiness evaluation as that involved in extending loan facilities to customers. Downey evaluates each customer's creditworthiness on a case-by-case basis. Undisbursed loan funds and unused lines of credit include home equity lines of credit and funds not disbursed, but committed to construction and commercial lending by the Bank.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party.

Downey receives collateral to support commitments for which collateral is deemed necessary. The most significant categories of collateral include real estate properties underlying mortgage loans, liens on personal property and cash on deposit with Downey. At December 31, 2000, the extent

of collateral supporting mortgage and other loans varied from nothing to 100% of the maximum credit exposure.

In connection with its interest rate risk management, Downey may enter into interest rate exchange agreements ("swap contracts") with certain national investment banking firms under terms that provide mutual payment of interest on the outstanding notional amount of the swap. The effect of these swaps serve to reduce Downey's interest rate risk between repricing assets and liabilities. At December 31, 2000, no swap contracts were outstanding.

(24) Risk Management

Derivative financial instruments are utilized to minimize the effect of future fluctuations in interest rates as part of our secondary marketing activities. Downey utilizes forward sale and purchase contracts to hedge the value of loans designated for sale against adverse changes in interest rates. These contracts are used to secure an agreed upon price at a future, fixed delivery or receipt settlement date and the contracts mature in less than one year. Gains or losses are recognized at the time the contracts mature and are recorded as a component of gains on sales of loans and mortgage-backed securities. At December 31, 2000, forward sales contracts to hedge loans designated for sale amounted to $150 million. These contracts expose Downey to credit risk in the event of nonperformance by the other parties--primarily government-sponsored enterprises such as Federal National Mortgage Association or Federal Home Loan Mortgage Corporation --to such agreements. This risk consists primarily of the termination value of

agreements where Downey is in a favorable position. Downey controls the credit risk associated with its other parties to the various derivative agreements through credit review, exposure limits and monitoring procedures. Downey does not anticipate nonperformance by the other parties.

(25) Fair Value of Financial Instruments

Fair value estimates are made at a specific point in time based upon relevant market information and other information about the financial instrument. The estimates do not necessarily reflect the price Downey might receive if it were to sell at one time its entire holding of a particular financial instrument. Because no active market exists for a significant portion of Downey's financial instruments, fair value estimates are based upon the following methods and assumptions, some of which are subjective in nature. Changes in assumptions could significantly affect the estimates.

Cash, Federal Funds Sold and Securities Purchased Under Resale Agreements

The carrying amounts reported in the balance sheet for these items approximate fair value.

Investment Securities Including U.S. Treasuries and Mortgage-Backed Securities

Fair value is based upon bid prices published in financial newspapers or

bid quotations received from securities dealers.

Loans Receivable

For residential mortgage loans, fair value is estimated based upon market prices obtained from readily available market quote systems. The remaining portfolio was segregated into those loans with variable rates of interest and those with fixed rates of interest. For non-residential variable rate loans which reprice frequently, fair values approximate carrying values. For non-residential fixed rate loans, fair values are based on discounting future contractual cash flows using the current rate offered for such loans with similar remaining maturities and credit risk. The amounts so determined for each category of loan are reduced by the associated allowance for loan losses which thereby takes into consideration changes in credit risk.

Interest-Bearing Advances to Joint Ventures

The carrying amounts approximate fair value as the interest earned is based upon a variable rate.

Federal Home Loan Bank Stock

The carrying amounts approximate fair value.

Mortgage Servicing Rights

The fair value of MSRs related to loans serviced for others is determined by computing the present value of the expected net servicing income from the portfolio.

Deposits

The fair value of deposits with no stated maturity such as regular passbook accounts, money market accounts and checking accounts, is the carrying amount reported in the balance sheet. The fair value of deposits with a stated maturity such as certificates of deposit is based on discounting future contractual cash flows by the current rate offered for such deposits with similar remaining maturities.

Borrowings

For short-term borrowings, fair value approximates carrying value. The fair value of long-term borrowings is based on their interest rate characteristics. For variable rate borrowings, fair values approximate carrying values. For fixed rate borrowings, fair value is based on discounting future contractual cash flows by the current rate paid on such borrowings with similar remaining maturities.

Capital Securities

Fair value is based upon closing stock price published in financial information services or newspapers.

Off-Balance-Sheet Financial Instruments

Outstanding commitments to sell loans and mortgage-backed securities, commitments to purchase mortgage-backed securities, standby letters of credit and other contingent liabilities, unused lines of credit, commitments to originate loans and mortgage-backed securities are essentially carried at zero with a fair value of less than $1 million. See Note 23 on page 97, for information concerning the notional amount of such financial instruments.

Based on the above methods and assumptions, the following table presents the estimated fair value of Downey's financial instruments:

	December 31, 2000	
(In Thousands)	Carrying Amount (1)	Estimate Fair Val
Assets:		
Cash	$ 108,202	$ 108,20
Federal funds	19,601	19,60
U.S. Government and agency obligations and other investment securities available for sale	305,615	305,61
Municipal securities held to maturity	6,550	6,53
Loans held for sale	251,572	254,54
Mortgage-backed securities available for sale	10,203	10,20
Loans receivable held for investment: Loans secured by real estate:		
Residential:		
Adjustable	8,990,538	9,104,25
Fixed	479,877	481,61
Other	236,659	243,58
Non-mortgage loans:		
Commercial	16,275	16,97
Consumer	99,229	100,53
Interest-bearing advances to joint ventures	12,339	12,33
Federal Home Loan Bank stock	106,356	106,35
MSRs and loan servicing portfolio (2)	40,731	43,16
Liabilities:		
Deposits:		
Transaction accounts	1,483,486	1,483,48
Certificates of deposit	6,599,203	6,619,45
Borrowings	1,978,572	1,978,80
Capital securities	120,000	122,40

(26) Business Segment Reporting

Downey views its business as consisting of two reportable business segments--banking and real estate investment. The accounting policies of the segments are the same as those described in Note 1, Summary of Significant Accounting Policies on page 69. Downey evaluates performance based on the net income generated by each segment. Internal expense allocations between segments are independently negotiated and, where possible, service and price is measured against comparable services available in the external marketplace.

The following describes the two business segments.

Banking

The principal business activities of this segment are attracting funds from the general public and institutions and originating and investing in loans, primarily residential real estate mortgage loans, mortgage-backed securities and investment securities.

This segment's primary sources of revenue are interest earned on mortgage loans and mortgage-backed securities, income from investment securities, gains on sales of loans and mortgage-backed securities, fees earned in connection with loans and deposits and income earned on its portfolio of loans and mortgage-backed securities serviced for investors.

This segment's principal expenses are interest incurred on interest-bearing liabilities, including deposits and borrowings, and general and administrative costs.

Real Estate Investment

Real estate development and joint venture operations are conducted principally through the Bank's wholly owned service corporation subsidiary, DSL Service Company. However, Downey Financial Corp. owned one investment in land which it purchased from DSL Service Company at fair value in 1995 and sold in 1999.

DSL Service Company participates as an owner of, or a partner in, a variety of real estate development projects, principally retail neighborhood shopping center developments, most of which are located in California. Most of the real estate development projects have been completed and are substantially leased.

In its joint ventures, DSL Service Company is entitled to interest on its equity invested in the project on a priority basis after third-party debt and shares profits and losses with the developer partner, generally on an equal basis. Partnership equity (deficit) accounts are affected by current period results of operations, additional partner advances, partnership distributions and partnership liquidations.

This segment's primary sources of revenue are net rental income and gains from the sale of real estate investment assets. This segment's principal expenses are interest expense and general and administrative expense.

Operating Results and Assets

The following presents the operating results and selected financial data by major business segments for 2000, 1999 and 1998:

(In Thousands)	Banking	Real Estate Investment	Elimination	
Year ended December 31 2000:				
Net interest income	$ 262,232	$ 243	$ --	$
Provision for loan losses	3,251	--	--	
Other income	41,406	9,148	--	
Operating expense	135,996	1,473	--	
Net intercompany income (expense)	397	(397)	--	
Income before income tax expense	164,788	7,521	--	
Income tax expense	69,966	3,092	--	
Net income	$ 94,822	$ 4,429	$ --	$
Assets at December 31 2000:				
Loans and mortgage-backed securities	$ 10,084,353	$ --	$ --	$
Real estate held for investment	--	17,641	--	
Other	806,201	3,584	(17,916)	
Total assets	10,890,554	21,225	(17,916)	
Equity	$ 624,636	$ 17,916	$ (17,916)	$
Year ended December 31 1999:				
Net interest income (expense)	$ 207,784	$ (306)	$ --	$
Provision for loan losses	11,270	--	--	
Other income	39,755	19,523	--	
Operating expense	143,081	1,794	--	
Net intercompany income (expense)	393	(393)	--	
Income before income tax expense	93,581	17,030	--	
Income tax expense	39,785	7,022	--	
Net income	$ 53,796	$ 10,008	$ --	$
Assets at December 31 1999:				
Loans and mortgage-backed securities	$ 8,746,063	$ --	$ --	$
Real estate held for investment	--	42,172	--	
Other	654,745	7,399	(42,839)	
Total assets	9,400,808	49,571	(42,839)	
Equity	$ 532,418	$ 42,839	$ (42,839)	$
Year ended December 31 1998:				
Net interest income (expense)	$ 174,967	$ (620)	$ --	$
Provision for (reduction of) loan losses	3,918	(19)	--	
Other income	24,617	22,736	--	
Operating expense	113,954	2,706	--	
Net intercompany income (expense)	(107)	107	--	

Income before income tax expense	81,605	19,536	--	
Income tax expense	34,869	8,299	--	
Net income	$ 46,736	$ 11,237		$
Assets at December 31 1998:				
Loans and mortgage-backed securities	$ 5,788,365	$ --	$ --	$
Real estate held for investment	--	49,447	--	
Other	464,097	9,841	(41,331)	
Total assets	6,252,462	59,288	(41,331)	
Equity	$ 480,566	$ 41,331	$ (41,331)	$

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DOWNEY FINANCIAL CORP. AND SUBSIDIARIES
Notes to Consolidated Financial Statements----(Continued)

(27) Selected Quarterly Financial Data (Unaudited)

Selected quarterly financial data are presented below by quarter for the years ended December 31, 2000 and 1999:

(In Thousands, Except Per Share Data)	December 31, 2000	September 30, 2000	June 30, 2000
Total interest income	$209,775	$204,370	$192,700
Total interest expense	140,838	137,160	129,135
Net interest income	68,937	67,210	63,565
Provision for loan losses	511	1,007	942
Net interest income after provision for loan losses	68,426	66,203	62,623
Total other income	7,545	12,065	9,467
Total operating expense	36,344	32,476	32,924
Income before income taxes	39,627	45,792	39,166
Income taxes	16,632	19,454	16,684
Net income	$ 22,995	$ 26,338	$ 22,482
Net income per share:			
Basic	$ 0.81	$ 0.94	$ 0.80
Diluted	0.81	0.93	0.80
Market range:			
High bid	$ 60.88	$ 40.94	$ 33.00
Low bid	33.13	29.94	20.44
End of period	55.00	39.50	28.98

	December 31, 1999	September 30, 1999	June 30, 1999
Total interest income	$161,244	$136,404	$122,209
Total interest expense	104,962	85,361	71,012
Net interest income	56,282	51,043	51,197
Provision for loan losses	3,253	2,838	2,798
Net interest income after provision for loan losses	53,029	48,205	48,399
Total other income	18,406	16,271	13,259
Total operating expense	37,092	35,805	35,521
Income before income taxes	34,343	28,671	26,137
Income taxes	14,507	12,109	11,079
Net income	$ 19,836	$ 16,562	$ 15,058
Net income per share:			
Basic	$ 0.71	$ 0.59	$ 0.53
Diluted	0.70	0.59	0.53
Market range:			
High bid	$ 22.94	$ 24.13	$ 23.00
Low bid	19.06	19.81	18.13
End of period	20.19	20.13	21.94

(28) Parent Company Financial Information

Downey Financial Corp. was incorporated in Delaware on October 21, 1994. On January 23, 1995, after obtaining necessary stockholder and regulatory approvals, Downey Financial Corp. acquired 100% of the issued and outstanding capital stock of the Bank, and the Bank's stockholders became stockholders of Downey Financial Corp. The transaction was accounted for in a manner similar to a pooling-of-interests under generally accepted accounting principles. Downey Financial Corp. was thereafter funded by a $15 million dividend from the Bank. Condensed financial statements of Downey Financial Corp. only are as follows:

Condensed Balance Sheets

	December 31,	
(In Thousands)	2000	1999
Assets		
Cash	$ 11	$ 7
Due from Bank - interest bearing	17,635	12,686
Investment in subsidiaries:		

Bank	722,829	636,213
Downey Financial Capital Trust I ..	3,711	3,711
Downey Affiliated Insurance Agency	202	204
Real estate held for investment	--	--
Other assets	5,028	5,016
	$749,416	$657,837
Liabilities and Stockholders' Equity		
Junior subordinated debentures	$123,711	$123,711
Accounts payable and accrued expenses	1,069	1,708
Total liabilities	124,780	125,419
Stockholders' equity	624,636	532,418
	$749,416	$657,837

DOWNEY FINANCIAL CORP. AND SUBSIDIARIES
Notes to Consolidated Financial Statements----(Continued)

Condensed Statements of Income and Other Comprehensive Income

	Years Ended Decem	
(In Thousands)	2000	1999
Income:		
Dividends from the Bank	$ 21,985	$ 5,011
Interest income	933	1,635
Other income	59	104
Total income	22,977	6,750
Expense:		
Interest expense	12,163	5,353
Provision for (reduction of) losses on real estate	--	(1,720)
General and administrative expense	816	896
Total expense	12,979	4,529
Income before income taxes and equity in undistributed net income of subsidiaries	9,998	2,221
Income tax benefit	4,895	1,162
Income before equity in undistributed net income of subsidiaries	14,893	3,383
Equity in undistributed net income of subsidiaries	84,358	60,421
Net income	99,251	63,804
Other comprehensive income (loss), net of income taxes (benefits):		
Unrealized gains (losses) on securities available for sale:		
U.S. Treasury securities, agency obligations and other		

investment securities available for sale, at fair value ..	2,032	(1,874)
Mortgage-backed securities available for sale, at fair value	173	(281)
Less reclassification of realized gains (losses) included in net income	(50)	166
Total other comprehensive income (loss), net of income taxes (benefits)	2,255	(2,321)
Comprehensive income	$ 101,506	$ 61,483

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DOWNEY FINANCIAL CORP. AND SUBSIDIARIES
Notes to Consolidated Financial Statements----(Continued)

Condensed Statements of Cash Flows

	Years Ended December 31,		
(In Thousands)	2000	1999	199
Cash flows from operating activities:			
Net income	$ 99,251	$ 63,804	$ 57,
Equity in undistributed net income of subsidiaries	(84,358)	(60,421)	(48,
Provision for (recovery of) losses on real estate	--	(1,720)	
Increase (decrease) in liabilities	(639)	1,449	
Other, net	(13)	1,022	
Net cash provided by operating activities	14,241	4,134	10,
Cash flows from investing activities:			
Capital contribution to the Bank	--	(107,600)	-
Increase in due from Bank - interest bearing	(4,949)	(4,165)	(1,
Sales of wholly owned real estate	--	2,201	-
Net cash used for investing activities	(4,949)	(109,564)	(1,
Cash flows from financing activities:			
Issuance of junior subordinated debentures	--	115,063	-
Exercise of stock options	855	219	
Dividends on common stock	(10,143)	(9,850)	(8,
Other	--	--	
Net cash provided by (used for) financing activities	(9,288)	105,432	(8,
Net increase (decrease) in cash and cash equivalents	4	2	
Cash and cash equivalents at beginning of period	7	5	
Cash and cash equivalents at end of period	$ 11	$ 7	$

(29) Sale of Subsidiary

On February 29, 2000, Downey Savings and Loan Association, F.A. sold its indirect automobile finance subsidiary, Downey Auto Finance Corp., to Auto

One Acceptance Corp., a subsidiary of California Federal Bank and recognized a pre-tax gain from the sale of $9.8 million. As of December 31, 1999, Downey Auto Finance Corp. had loans totaling $366 million and total assets of $373 million. The proceeds of the sale provided additional capital to further the growth of our residential lending business.

Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Downey Financial Corp. intends to file with the Securities and Exchange Commission a definitive proxy statement (the "Proxy Statement") pursuant to Regulation 14A, which will involve the election of directors, within 120 days of the end of the year covered by this Form 10-K. Information regarding directors of Downey Financial Corp. will appear under the caption "Election of Directors" in the Proxy Statement for the Annual Meeting of Stockholders to be held on April 25, 2001, and is incorporated herein by reference. Information regarding executive officers of Downey Financial Corp. will appear under the caption "Executive Officers" in the Proxy Statement and is incorporated herein by this reference.

ITEM 11. EXECUTIVE COMPENSATION

Information regarding executive compensation will appear under the caption "Executive Compensation" in the Proxy Statement and is incorporated herein by this reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Information to be included under the captions "Securities Ownership of Certain Beneficial Owners and Management" in the Proxy Statement is incorporated herein by this reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Information to be included under the caption "Certain Relationships and Related Transactions" in the Proxy Statement is incorporated herein by this reference.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) 1. Financial Statements.

These documents are listed in the Index to Consolidated Financial Statements under Item 8.

2. Financial Statement Schedules.

Financial Statement Schedules have been omitted because they are not applicable or the required information is shown in the Consolidated

Financial Statements or Notes thereto.

(b) Reports on Form 8-K during the last quarter of 2000.

None.

(c) Exhibits.

Exhibit Number	Description
3.1	(2) Certificate of Incorporation of Downey Financial Corp.
3.2	(1) Bylaws of Downey Financial Corp.
4.1	(4) Junior Subordinated Indenture dated as of July 23, 1999 between Downey Financial Corp. and Wilmington Trust Company as Indenture Trustee.
4.2	(4) 10% Junior Subordinated Debenture due September 15, 2029 Principal Amount $123,711,350.
4.3	(4) Certificate of Trust of Downey Financial Capital Trust I, dated as of May 25, 1999.
4.4	(4) Trust Agreement of Downey Financial Capital Trust I, dated May 25, 1999.
4.5	(4) Amended and Restated Trust Agreement of Downey Financial Capital Trust I, between Downey Financial Corp., Wilmington Trust Company and the Administrative Trustees named therein, dated as of July 23, 1999.
4.6	(4) Certificate Evidencing Common Securities of Downey Financial Capital Trust I, 10% Common Securities.
4.7	(4) Certificate Evidencing Capital Securities of Downey Financial Capital Trust I, 10% Capital Securities (Global Certificate).
4.8	(4) Common Securities Guarantee Agreement of Downey Financial Corp. (Guarantor), dated July 23, 1999.
4.9	(4) Capital Securities Guarantee Agreement of Downey Financial Corp. and Wilmington Trust Company, dated as of July 23, 1999.
10.1	(3) Downey Savings and Loan Association, F.A. Employee Stock Purchase Plan (Amended and Restated as of January 1, 1996).
10.2	(3) Amendment No. 1, Downey Savings and Loan Association, F.A. Employee Stock Purchase Plan. Amendment No. 1, Effective and Adopted January 22, 1997.
10.3	(3) Downey Savings and Loan Association, F.A. Employees' Retirement and Savings Plan (October 1, 1997 Restatement).
10.4	(3) Amendment No. 1, Downey Savings and Loan Association, F.A. Employees' Retirement and Savings Plan (October 1, 1997 Restatement) Amendment No. 1, Effective and Adopted January 28, 1998.

10.5 (3) Trust Agreement for Downey Savings and Loan Association, F.A. Employees' Retirement and Savings Plan, Effective October 1, 1997 between Downey Savings and Loan Association, F.A. and Fidelity Management Trust Company.

10.6 (2) Downey Savings and Loan Association 1994 Long-Term Incentive Plan (as amended).

(c) Exhibits (Continued)

Exhibit Number	Description
10.7	(1) Asset Purchase Agreement among Butterfield Savings and Loan Association, FSA, Mortgage Investment, Inc., Property Management Service, Inc. and Butterfield Capital Corporation, dated September 1, 1988.
10.8	(1) Assistance Agreement between and among the Federal Savings and Loan Insurance Corporation, Butterfield Savings and Loan Association, FSA and Downey Savings and Loan Association, dated September 29, 1988 (confidential treatment requested due to contractual prohibition against disclosure).
10.9	(1) Merger of Butterfield Savings and Loan Association, FSA, into Downey Savings and Loan Association, dated September 29, 1989.
10.10	(1) Founder Retirement Agreement of Maurice L. McAlister, dated December 21, 1989.
10.11	(5) Amendment No. 1, Founders Retirement Agreement of Maurice L. McAlister, dated December 21, 1989. Amendment No. 1, Effective and Adopted July 26, 2000. 10.12 (1) Founder Retirement Agreement of Gerald H. McQuarrie, dated December 21, 1989.
10.13	Deferred Compensation Program.
10.14	Director Retirement Benefits.
22	Subsidiaries.
23	Consent of Independent Auditors.
27	Financial Data Schedule (Only filed as part of the EDGAR version).

(1) Filed as part of Downey's Registration Statement on Form 8-B/A filed January 17, 1995.
(2) Filed as part of Downey's Registration Statement on Form S-8 filed February 3, 1995.
(3) Filed as part of Downey's report on Form 10-K filed March 16, 1998.
(4) Filed as part of Downey's report on Form 10-Q filed November 2, 1999.
(5) Filed as part of Downey's report on Form 10-Q filed August 2, 2000.

We will furnish any or all of the non-confidential exhibits upon payment of a reasonable fee. Please send request for exhibits and/or fee information to:

Downey Financial Corp.
3501 Jamboree Road
Newport Beach, California 92660
Attention: Corporate Secretary

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SIGNATURES

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

DOWNEY FINANCIAL CORP.

By: /s/ DANIEL D. ROSENTHAL
Daniel D. Rosenthal
President and Chief Executive Officer
Director

DATED: March 7, 2001

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature	Title	Date
Maurice L. McAlister	Chairman of the Board Director	March 7, 2001
/s/ CHERYL E. OLSON Cheryl E. Olson	Vice Chairman of the Board Director	March 7, 2001
/s/ DANIEL D. ROSENTHAL Daniel D. Rosenthal	President and Chief Executive Officer Director	March 7, 2001
/s/ THOMAS E. PRINCE Thomas E. Prince	Executive Vice President Chief Financial Officer (Principal Financial and Accounting Officer)	March 7, 2001
/s/ MICHAEL ABRAHAMS Michael Abrahams	Director	March 7, 2001
/s/ DR. PAUL KOURI Dr. Paul Kouri	Director	March 7, 2001

/s/ BRENT MCQUARRIE ------------------------- Brent McQuarrie	Director	March 7, 2001
/s/ LESTER C. SMULL ------------------------- Lester C. Smull	Director	March 7, 2001
/s/ SAM YELLEN ------------------------- Sam Yellen	Director	March 7, 2001