COMMERCIAL FEDERAL CORP
Form 10-Q
November 09, 2005

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2005

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 1-11515

COMMERCIAL FEDERAL CORPORATION

(Exact name of registrant as specified in its charter)

Nebraska	**47-0658852**
(State or other jurisdiction of	**(I. R. S. Employer**

incorporation or organization)	**Identification Number)**
13220 California Street, Omaha, Nebraska	**68154**
(Address of principal executive offices)	**(Zip Code)**

(402) 554-9200

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant is an accelerated filer as defined in Rule 12b-2 of the Securities Exchange

Act of 1934. YES x NO ¨

Indicate by check mark whether the registrant is a shell company as defined in Rule 12b-2 of the Securities Exchange

Act of 1934. YES ¨ NO x

As of October 31, 2005, the registrant had 38,290,523 shares outstanding of its common stock, par value $.01 per share.

COMMERCIAL FEDERAL CORPORATION

FORM 10-Q

INDEX

PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

COMMERCIAL FEDERAL CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL CONDITION

(Unaudited)

(Dollars in Thousands Except Par Value)	September 30, 2005	December 31, 2004
ASSETS		
Cash (including short-term investments of $3,158 and $35,334)	$ 172,906	$ 189,179
Investment securities available for sale, at fair value	510,420	1,071,223
Mortgage-backed securities available for sale, at fair value	610,705	996,844
Loans held for sale, net	49,744	276,772
Loans receivable, net of allowances of $89,266 and $89,841	7,850,988	7,698,970
Federal Home Loan Bank stock	169,166	204,409
Foreclosed real estate	13,710	17,835
Premises and equipment, net	183,560	174,394
Bank owned life insurance	253,687	251,581
Other assets	180,890	395,099
Core value of deposits, net of accumulated amortization of $71,530 and $68,619	9,519	12,430
Goodwill	159,229	162,717
Total Assets	$ 10,164,524	$ 11,451,453
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Deposits	$ 6,066,243	$ 6,422,783
Advances from Federal Home Loan Bank	2,810,225	3,685,630
Other borrowings	428,637	310,958
Other liabilities	86,935	242,752
Total Liabilities	9,392,040	10,662,123
Commitments and Contingencies		
Stockholders Equity:		
Preferred stock, $.01 par value; 10,000,000 shares authorized; none issued		
Common stock, $.01 par value; 120,000,000 shares authorized; 38,287,922 and 39,254,139 shares issued and outstanding	383	393
Retained earnings	766,453	826,169
Accumulated other comprehensive income (loss), net	5,648	(37,232)
Total Stockholders Equity	772,484	789,330
Total Liabilities and Stockholders Equity	$ 10,164,524	$ 11,451,453

See accompanying Notes to Condensed Consolidated Financial Statements.

COMMERCIAL FEDERAL CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in Thousands)	**2005**	**2004**	**2005**	**2004**
Interest Income:				
Loans receivable	$ 126,361	$ 116,447	$ 361,485	$ 356,308
Mortgage-backed securities	7,029	10,930	24,736	34,943
Investment securities	8,440	14,628	31,125	42,543
Total interest income	141,830	142,005	417,346	433,794
Interest Expense:				
Deposits	33,807	28,765	99,097	85,449
Advances from Federal Home Loan Bank	33,717	45,191	104,023	132,816
Other borrowings	6,799	3,960	23,399	9,047
Total interest expense	74,323	77,916	226,519	227,312
Net Interest Income	67,507	64,089	190,827	206,482
Provision for Loan Losses	(7,878)	(2,869)	(20,277)	(10,828)
Net Interest Income After Provision for Loan Losses	59,629	61,220	170,550	195,654
Other Income (Loss):				
Retail fees and charges	21,151	17,625	56,106	49,003
Loan servicing fees, net of mortgage servicing rights amortization	793	138	4,361	(5,213)
Mortgage servicing rights valuation adjustment, net	(2)	(21,644)	7,598	(1,671)
Gain (loss) on sales of securities		12,588	(16,621)	(1,787)
Changes in fair values of derivatives, net	(766)	8,665	(2,052)	2,432
Loss on termination of interest rate swap agreements			(42,457)	
Loss on early extinguishment of debt			(40,731)	
Gain on sale of mortgage servicing rights and wholesale mortgage origination network	76		3,382	
Gain on sales of loans	2,637	1,393	5,927	4,107
Bank owned life insurance	2,812	2,900	8,684	13,946
Other operating income	10,252	7,926	22,385	21,690
Total other income	36,953	29,591	6,582	82,507
Other Expense:				
General and administrative expenses -				
Compensation and benefits	32,615	30,582	99,971	95,005
Occupancy and equipment	9,758	9,825	28,997	29,983
Data processing	5,478	4,698	15,656	13,962
Advertising	3,690	2,963	8,180	10,458
Communication	3,107	3,263	9,165	9,741
Item processing	2,872	3,195	8,650	9,381
Outside services	2,526	4,087	8,414	11,831
Loan expenses	588	1,494	3,407	5,444
Foreclosed real estate, net	415	643	2,359	1,351
Other operating expenses	3,309	2,266	8,157	11,724
Merger costs	558		8,136	

Exit costs	75		3,731	
Total general and administrative expenses	64,991	63,016	204,823	198,880
Amortization of core value of deposits	964	984	2,911	3,419
Impairment of goodwill			3,488	
Total other expense	65,955	64,000	211,222	202,299
Income (Loss) Before Income Taxes	30,627	26,811	(34,090)	75,862
Income Tax Provision (Benefit)	7,590	6,578	(17,882)	19,009
Net Income (Loss)	$ 23,037	$ 20,233	$ (16,208)	$ 56,853

COMMERCIAL FEDERAL CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS (Continued)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	**2004**	**2005**	**2004**
Weighted Average Number of Common Shares Outstanding Used in Basic Earnings (Loss) Per Share Calculation	38,043,281	39,583,989	38,392,520	40,361,719
Add Assumed Exercise of Outstanding Stock Options as Adjustments for Dilutive Securities (1)	1,236,075	666,114		706,991
Weighted Average Number of Common Shares Outstanding Used in Diluted Earnings (Loss) Per Share Calculation	39,279,356	40,250,103	38,392,520	41,068,710
Basic Earnings (Loss) Per Common Share	$ .61	$ .51	$ (.42)	$ 1.41
Diluted Earnings (Loss) Per Common Share (1)	$ .59	$ .50	$ (.42)	$ 1.38
Dividends Declared Per Common Share	$ .145	$ .135	$ .425	$ .395

(1) The conversion of stock options for the nine months ended September 30, 2005 is not assumed since the Corporation incurred a loss from operations. As a result, for the nine months ended September 30, 2005, the diluted loss per share is computed the same as the basic loss per share.

See accompanying Notes to Condensed Consolidated Financial Statements.

COMMERCIAL FEDERAL CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in Thousands)	**2005**	**2004**	**2005**	**2004**
Net Income (Loss)	$ 23,037	$ 20,233	$ (16,208)	$ 56,853
Other Comprehensive Income (Loss):				
Unrealized holding gains (losses) on securities available for sale	(9,525)	49,207	(36,551)	8,766
Fair value adjustment on interest rate swap agreements	3,602	(16,999)	34,349	19,957
Reclassification of net losses (gains) included in net income (loss) pertaining to:				
Securities sold		(12,588)	16,621	1,787
Termination of interest rate swap agreements			42,457	
Amortization of net deferred loss on terminated interest rate swap agreements	2,269	4,984	9,464	14,845
Other Comprehensive Income (Loss) Before Income Taxes	(3,654)	24,604	66,340	45,355
Income Tax Provision (Benefit)	(1,039)	8,613	23,460	15,879
Other Comprehensive Income (Loss)	(2,615)	15,991	42,880	29,476
Comprehensive Income	$ 20,422	$ 36,224	$ 26,672	$ 86,329

See accompanying Notes to Condensed Consolidated Financial Statements.

COMMERCIAL FEDERAL CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

(Unaudited)

	Nine Months Ended September 30,	
(Dollars in Thousands)	**2005**	**2004**
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$ (16,208)	$ 56,853
Adjustments to reconcile net income (loss) to net cash from operating activities:		
Amortization of core value of deposits	2,911	3,419
Impairment of goodwill	3,488	
Depreciation and amortization	12,743	13,026
Amortization of deferred discounts and fees, net of premiums	5,264	16,712
Amortization of mortgage servicing rights	8,889	37,901
Amortization of net deferred loss on terminated interest rate swap agreements	9,464	14,845
Valuation adjustment of mortgage servicing rights, net	(7,598)	1,671
Provision for losses on loans	20,277	10,828
Loss on termination of interest rate swap agreements	42,457	
Proceeds from termination of interest rate swap and swaption agreements	28,347	
Payments related to termination of interest rate swap agreements	(42,457)	
Loss on early extinguishment of debt	40,731	
Gain on sales of loans	(5,927)	(4,107)
Loss (gain) on sales of securities and changes in fair values of derivatives, net	18,673	(645)
Gain on sale of mortgage servicing rights and wholesale mortgage origination network	(3,382)	
Proceeds from sales of loans	990,424	2,204,687
Origination of loans for resale	(444,896)	(662,153)
Purchases of loans for resale	(418,679)	(1,509,315)
Increase in bank owned life insurance	(2,106)	(13,946)
Stock dividends from Federal Home Loan Bank	(6,122)	(6,200)
Decrease in broker receivable from sales of securities and derivative settlements	1,673	36,984
Decrease in broker payable on derivative settlements and purchases of securities	(52,650)	(61,802)
Decrease in interest receivable	7,401	2,057
Increase (decrease) in interest payable	(2,411)	90
Increase (decrease) in other liabilities, net	(32,797)	11,866
Other items, net	27,760	7,739
Total adjustments	201,477	103,657
Net cash provided by operating activities	185,269	160,510
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of loans	(22,633)	(163,541)
Repayment of loans, net of originations	(81,288)	486,786
Proceeds from sales of investment securities available for sale	672,925	1,420,181
Purchases of investment securities available for sale	(354,426)	(1,422,131)
Maturities and principal repayments of investment securities available for sale	219,659	3,276
Proceeds from sales of mortgage-backed securities available for sale	783,624	
Purchases of mortgage-backed securities available for sale	(521,100)	(17)
Principal repayments of mortgage-backed securities available for sale	109,176	272,898
Proceeds from sales of mortgage servicing rights and wholesale mortgage origination network	127,709	

Proceeds from sales of Federal Home Loan Bank stock	55,544	51,948
Purchases of Federal Home Loan Bank stock	(14,179)	(4,700)
Proceeds from sales of real estate	14,289	25,574
Payments to acquire real estate		(2,318)
Purchases of premises and equipment, net	(19,071)	(29,640)
Other items, net		7,243
Net cash provided by investing activities	970,229	645,559

COMMERCIAL FEDERAL CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS (Continued)

(Unaudited)

	Nine Months Ended September 30,	
(Dollars in Thousands)	**2005**	**2004**
CASH FLOWS FROM FINANCING ACTIVITIES		
Net decrease in deposits	$ (356,540)	$ (205,388)
Proceeds from Federal Home Loan Bank advances	500,000	807,600
Repayments of Federal Home Loan Bank advances	(1,414,577)	(1,519,300)
Proceeds from securities sold under agreements to repurchase	12,180	215,126
Repayments of securities sold under agreements to repurchase	(12,419)	(15,326)
Proceeds from issuances of other borrowings	149,482	13,467
Repayments of other borrowings	(4,000)	(7,050)
Purchases of interest rate swap and swaption agreements	(94)	(13,441)
Payments of cash dividends on common stock	(16,132)	(15,721)
Repurchases of common stock	(40,843)	(66,117)
Issuance of common stock	11,172	7,600
Net cash used by financing activities	(1,171,771)	(798,550)
CASH AND CASH EQUIVALENTS		
Increase (decrease) in net cash position	(16,273)	7,519
Balance, beginning of year	189,179	158,133
Balance, end of period	$ 172,906	$ 165,652
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid (received) during the period for:		
Interest expense	$ 225,203	$ 219,027
Income taxes, net	(3,954)	(12,950)
Non-cash investing and financing activities:		
Loans exchanged for mortgage-backed securities	2,518	14,403
Loans transferred to real estate	13,371	21,405
Loans originated for sale of foreclosed real estate		23,835
Net increase (decrease) to loans held for sale and other borrowings under the Government National Mortgage Association optional repurchase program	(28,873)	2,867
Capital lease and financing obligations incurred	676	9,272
Other items, net		(274)

See accompanying Notes to Condensed Consolidated Financial Statements.

COMMERCIAL FEDERAL CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

AS OF AND FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2005

(Unaudited)

(Columnar Dollars in Footnotes are in Thousands Except Per Share Amounts)

A. FINANCIAL STATEMENT PRESENTATION:

References in this document to the Corporation are to Commercial Federal Corporation and its consolidated subsidiaries, including its wholly-owned subsidiary, Commercial Federal Bank, a Federal Savings Bank, and its consolidated subsidiaries (the Bank). Parent company references in this document are to the unitary non-diversified savings and loan holding company only. Certain amounts in the prior year periods presented have been reclassified to conform to the September 30, 2005 presentation for comparative purposes. These amounts include the reclassification of interest expense related to certain capital lease and financing obligations from general and administrative expenses to interest expense on other borrowings.

The accompanying interim condensed consolidated financial statements have not been audited by the Corporation s independent registered public accounting firm. In the opinion of management, all adjustments considered necessary to fairly present the condensed consolidated financial statements have been included. The condensed statements should be read in conjunction with the audited financial statements and notes thereto included in the Corporation s Annual Report on Form 10-K for the year ended December 31, 2004. The results of operations for the three and nine months ended September 30, 2005 are not necessarily indicative of the results which may be expected for the remainder of the year.

B. MERGER AGREEMENT WITH BANK OF THE WEST:

On June 13, 2005, the Corporation and Bank of the West entered into an agreement and plan of merger pursuant to which the Corporation and the Bank will be merged into Bank of the West, a California state banking corporation and a subsidiary of BancWest Corporation (BancWest). The boards of directors of the Corporation, Bank of the West, BancWest and the board of BancWest s parent company, BNP Paribas, have approved the transaction. Stockholders of the Corporation approved the transaction at a November 1, 2005 special meeting and all regulatory approvals have been received. Subject to the terms and conditions of the merger agreement, each outstanding share of the Corporation s common stock will be converted into the right to receive $34.00 in cash. The Corporation will also declare and pay a special one-time cash dividend of $.50 per share immediately prior to completion of the merger. The merger is expected to close in December 2005.

The merger agreement includes terms and conditions which affect the conduct of the Corporation s business until the merger is completed or the agreement is terminated. Among other items, the merger agreement generally requires the Corporation to carry on business in its ordinary course consistent with past practice and in accordance with sound banking practices, and to observe in all material respects its legal and contractual obligations. The merger agreement generally restricts the ability of the Corporation to make material changes in any aspect of the conduct of its business without the consent of BancWest, including significant capital expenditures, new material lines of business or the disposition of assets or incurring of obligations outside of the ordinary course of business. The Corporation believes it is in compliance with its obligations under the merger agreement.

C. MERGER COSTS:

Reflected in merger costs for the nine-month period of 2005 is a $6.6 million write-off of a portion of the contract value related to one of the Corporation s bank owned life insurance (BOLI) policies. The contract value was previously increased in the first quarter of 2004 in other income as a result of an amendment to the BOLI policy which allows the Corporation to receive a guaranteed payment of a certain component of the BOLI policy if there is a full and complete surrender of all outstanding certificates of the BOLI policy under certain conditions. One of these conditions is that the Corporation has not undergone a change of control as defined by the amendment. Since the Corporation has met the definition of a change of control, as defined, as of June 13, 2005, due to the approval by the Corporation s board of directors of an agreement and plan of merger with the Corporation and Bank into Bank of the West, the payment of this portion of the contract value is no longer guaranteed and therefore, has been expensed as a merger-related cost. This component of the BOLI policy may in the future again be recorded as an increase to the contract value after certain conditions are met. Also included in merger costs are investment banking fees totaling $1.0 million and other miscellaneous merger costs totaling $558,000. The majority of the merger costs are not deductible for federal income tax purposes.

D. SALE OF MORTGAGE SERVICING AND WHOLESALE MORTGAGE ORIGINATION NETWORK:

During the quarter ended September 30, 2005, the Corporation sold its remaining mortgage servicing rights relating to $18.9 million of mortgage loans serviced for other investors for a total sales price of $260,000. For the three months ended June 30, 2005, the Corporation sold mortgage servicing rights relating to $1.2 billion of mortgage loans serviced for other investors for a total sales price of $18.0 million and during the quarter ended March 31, 2005, sold mortgage servicing rights relating to $9.3 billion of mortgage loans serviced for other investors and its broker and correspondent bank (wholesale) mortgage origination network for a total sales price of $120.0 million. These sales were in connection with the Corporation s plan to exit the mortgage loan servicing and wholesale mortgage loan origination businesses. Pre-tax gains relating to these sales totaling $76,000 and $3.4 million, respectively, were recorded during the three and nine months ended September 30, 2005. As of September 30, 2005, a net receivable totaling $5.5 million related to these sales remained outstanding from the buyers in accordance with contractual terms. In addition, during the first quarter of 2005, the Corporation also recognized a $3.5 million impairment loss on goodwill in accordance with the provisions of Statement of Financial Accounting Standards No. 142 Goodwill and Other Intangible Assets (SFAS No. 142) relating to its mortgage banking segment as a result of the Corporation exiting the mortgage loan servicing and wholesale mortgage loan origination businesses. No goodwill impairment was recognized during the second or third quarters of 2005.

The Corporation also entered into interim sub-servicing arrangements with the buyers of the mortgage servicing rights to continue to service the mortgage loans sold until the loan servicing was transferred. The transfer of loan servicing was completed in the 2005 third quarter. Associated with the Corporation s sale of mortgage servicing rights and the wholesale mortgage origination network, the Corporation recognized exit costs totaling $3.7 million which are included in the consolidated statement of operations in general and administrative expenses under the category exit costs. Approximately $2.1 million of the total exit costs charged to expense represents estimated contract termination costs. The Corporation also recorded severance expense under the exit costs category totaling $68,000 and $962,000, respectively, for the three and nine months ended September 30, 2005 related to the termination of the employees associated with these business activities. The Corporation expects to recognize total severance expense of approximately $1.0 million in 2005. These severance expenses are being recognized ratably over the various retention periods during which the terminated employees are required to render service. These retention periods and termination dates primarily correspond with the transfer of the mortgage loan servicing which occurred during the third quarter of 2005 and with the transfer of wholesale mortgage origination relationships which occurred in the second quarter of 2005. The Bank will continue to service its own residential mortgage portfolio which totaled $2.2 billion at September 30, 2005.

D. SALE OF MORTGAGE SERVICING AND WHOLESALE MORTGAGE ORIGINATION NETWORK (continued):

The activity for mortgage servicing rights and the valuation allowance for impairment of mortgage servicing rights for the periods indicated, as well as the ending balances of mortgage servicing rights and the respective fair values are summarized below:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Beginning balance before valuation allowance	$ 265	$ 175,266	$ 162,423	$ 185,233
Mortgage servicing rights retained through loan sales		6,966	6,308	24,284
Sale of mortgage servicing rights	(263)		(159,842)	
Amortization expense	(2)	(10,616)	(8,889)	(37,901)
Ending balance before valuation allowance		171,616		171,616
Valuation allowance, beginning balance	1	29,366	41,174	49,339
Amounts charged (credited) to operations	2	21,644	(7,598)	1,671
Sale of mortgage servicing rights	(3)		(33,576)	
Valuation allowance, ending balance		51,010		51,010
Mortgage servicing rights, net of valuation allowance	$	$ 120,606	$	$ 120,606
Fair value at the periods ended September 30	$	$ 121,876	$	$ 121,876

Mortgage loans serviced by the Bank at September 30 are summarized below:

	2005	2004
Total mortgage loans serviced by the Bank	$ 2,359,421	$ 13,817,952
Less loans sub-serviced for Bank of the West	189,054	
Total mortgage loans serviced by the Bank, excluding loans sub-serviced	$ 2,170,367	$ 13,817,952
Total mortgage loans serviced by the Bank, excluding loans sub-serviced:		
Loans owned by the Bank	$ 2,170,367	$ 2,914,995
Other investors		10,902,957
	$ 2,170,367	$ 13,817,952

E. DERIVATIVE FINANCIAL INSTRUMENTS:

In August 2005, the Corporation terminated interest rate swap agreements that were designated as cash flow hedges of variable interest payments associated with $200.0 million of high performance savings deposits. Since the hedged savings deposits were still outstanding at the time the interest rate swap agreements were terminated, the gain totaling $3.5 million recorded on the termination of the interest rate swap agreements was deferred as a component of other comprehensive income in the consolidated statement of financial condition. This gain is being amortized as a component of interest expense on savings deposits over the remaining term of the interest rate swap agreements. The unamortized balance of this gain totaled $3.3 million at September 30, 2005. Excluding mandatory forward sales commitments which are designated as hedges against the changes in fair value of mortgage loans held for sale in the secondary market (warehouse loans) which are discussed later in this footnote, there were no hedging transactions outstanding which qualified for hedge accounting under Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS No. 133), as of September 30, 2005.

In conjunction with the Corporation s sale of mortgage servicing rights as of March 31, 2005, the Corporation terminated interest rate floor agreements with a notional amount of $950.0 million and interest rate swaption agreements with a notional amount of $150.0 million during March 2005. At September 30, 2005, the Corporation continued to hold interest rate floor agreements with a notional amount of $600.0 million recorded as an asset with a fair value of $273,000 and an interest rate cap agreement with a notional amount of $100.0 million recorded as an asset with a fair value of $601,000 as free-standing derivatives for general balance sheet interest rate risk management purposes. Additionally, the Corporation holds interest rate swaption agreements with a notional amount of $7.0 million, which are accounted for as free-standing derivatives and are used to hedge certain interest rate lock commitments (IRLC).

In conjunction with the Corporation s sale of mortgage servicing rights, the Corporation prepaid certain Federal Home Loan Bank (FHLB) advances and terminated associated interest rate swap and swaption agreements during the quarter ended March 31, 2005 to realign its balance sheet to sustain an acceptable interest rate risk profile for the Corporation. Specifically, the Corporation terminated pay-fixed interest rate swap agreements with a notional amount of $720.0 million which had been accounted for as cash flow hedges on three-month adjustable-rate FHLB advances totaling $720.0 million. These adjustable-rate FHLB advances either were not renewed or were prepaid during March 2005. The termination of these pay-fixed interest rate swap agreements resulted in a cash payment of $42.5 million to the counterparty of the agreements and the recognition of a $42.5 million loss by the Corporation for the three months ended March 31, 2005.

Also, during the first quarter of 2005, the Corporation prepaid $600.0 million in convertible fixed-rate FHLB advances resulting in the recognition of a loss on early extinguishment of debt of $40.7 million comprised of a $19.1 million prepayment penalty paid to the FHLB and the write off of carrying value adjustments of $21.6 million associated with fair value hedges on these FHLB advances. Correspondingly, the Corporation terminated interest rate swaption agreements with a notional amount of $600.0 million and interest rate swap agreements with a notional amount of $200.0 million which had been accounted for as fair value hedges on this convertible fixed-rate FHLB debt. The Corporation received $7.7 million upon the termination of these agreements equal to the fair value of these derivatives. Subsequent to the payoff of the $600.0 million in convertible fixed-rate FHLB advances during March 2005, the Corporation entered into forward-starting interest rate swap agreements with a notional amount of $500.0 million to hedge the interest rate risk related to interest payments generated by the forecasted issuance of new fixed-rate FHLB advances. These forward-starting swaps were terminated when this new FHLB debt was taken down in the latter part of March 2005. The fair value gain of $2.3 million on these cash flow hedges was recorded in other comprehensive income in the consolidated statement of financial condition and is being amortized as a reduction to interest expense over the life of the new FHLB debt. At September 30, 2005, the unamortized balance of this gain totaled $2.1 million.

At September 30, 2005, the Corporation had IRLC to originate mortgage loans, net of estimated fallout, totaling $41.4 million and mandatory forward loan sales commitments totaling $74.0 million that are considered to be derivatives under SFAS No. 133. The IRLC are recorded as a liability with a fair value totaling $164,000 while the mandatory forward sales commitments are recorded as an asset with a fair value of $526,000 as of September 30, 2005. A portion of the mandatory forward sales commitments are designated as hedges against the changes in fair value of warehouse loans in circumstances which qualify for hedge accounting. The recognized gains and losses associated with forward loan sales and hedged warehouse loans qualifying for hedge accounting offset, resulting in minimal impact to the Corporation s earnings. The warehouse loans which do not qualify for hedge accounting are carried at the lower of cost or market. Additionally, the Corporation had option contracts with notional amounts totaling $10.0 million to provide protection for unexpected fluctuations in the fallout of loans with rate lock commitments.

F. GOODWILL AND CORE VALUE OF DEPOSITS:

The following table sets forth the estimated amortization expense for core value of deposits at September 30, 2005 for the remaining three months of 2005 and the next four years:

For the remaining three months for the year ended December 31, 2005	$ 964
For the years ended December 31:	
2006	3,233
2007	2,719
2008	2,242
2009	361
Total	$ 9,519

During the nine months ended September 30, 2005 the Corporation sold mortgage servicing rights relating to $10.5 billion of mortgage loans serviced for other investors and its wholesale mortgage origination network in connection with its plan to exit the mortgage servicing and wholesale mortgage origination businesses. See Note D, Sale of Mortgage Servicing and Wholesale Mortgage Origination Network, for additional information. Effective with the June 30, 2005 reporting period the Corporation s Mortgage Banking segment began reporting as Exited Operations for segment reporting purposes. Exited Operations reflects the results of servicing operations that continued until the transfer of the remaining servicing was completed in the 2005 third quarter. See Note I, Segment Information, for additional discussion on this change. Goodwill included in Mortgage Banking (Exited Operations) was deemed impaired with an impairment loss recorded as of March 31, 2005 in accordance with the provisions of SFAS No. 142. The table below sets forth the total carrying amount of goodwill by operating segment and the impairment loss recorded for Mortgage Banking (Exited Operations) for the periods indicated below:

Segment	**Balance December 31, 2004**	**Impairment Loss**	**Balance September 30, 2005**
Commercial Banking	$ 93,553	$	$ 93,553
Retail Banking	45,249		45,249
Treasury	20,427		20,427
Mortgage Banking / Exited Operations	3,488	3,488	
Total	$ 162,717	$ 3,488	$ 159,229

G. STOCK-BASED COMPENSATION:

The Corporation applies Accounting Principles Board Opinion No. 25 Accounting for Stock Issued to Employees (APB No. 25), and related interpretations in accounting for its stock option plans. No compensation cost was recognized for stock options granted, as all stock options granted had an exercise price equal to the market value of the underlying common stock on the date of grant. The effect on the Corporation s net income (loss) and earnings (loss) per share is presented in the following table as if compensation cost was determined based on the fair value at the grant dates for stock options awarded pursuant to the provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation (SFAS No. 123).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	**2004**	**2005**	**2004**
Net income (loss) as reported	$ 23,037	$ 20,233	$ (16,208)	$ 56,853
Deduct total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects	(603)	(702)	(2,232)	(2,925)
Pro forma net income (loss)	$ 22,434	$ 19,531	$ (18,440)	$ 53,928
Earnings (loss) per share:				
Basic -				
As reported	$ .61	$ .51	$ (.42)	$ 1.41
Pro forma	.59	.49	(.48)	1.34
Diluted -				
As reported	.59	.50	(.42)	1.38
Pro forma	.58	.49	(.48)	1.32

The fair value of each option grant after January 1, 2005 was estimated on the date of grant using a binomial lattice model and the fair value of each option grant prior to January 1, 2005 was estimated on the date of grant using the Black-Scholes option-pricing model. The pro forma expense for each option grant after January 1, 2005 is being amortized on an accelerated basis over the vesting period of the option grants and the pro forma expense for each option grant prior to January 1, 2005 was amortized on a straight-line basis over the vesting period of the option grants. Management believes the use of an accelerated basis of amortization, as if each separately vesting portion of the award was in substance a separate award, provides a more refined estimate of the expense, however, the effect was not material between the two assumptions. The option-pricing models calculate the fair value of stock options awarded based on subjective assumptions. Changes to these assumptions can materially affect the fair value calculation by the models. Therefore, management believes these fair value calculations may not result in a true reflection of the fair value or cost of stock-based compensation for the Corporation. See Note K, Current Accounting Pronouncements, relating to Statement of Financial Accounting Standards No. 123(R) Share-Based Payment.

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H. COMMITMENTS AND CONTINGENCIES:

The following table presents the Corporation s outstanding loan commitments at September 30, 2005, excluding undisbursed portions of loans in process:

Originate residential mortgage loans	$ 165,565
Originate commercial real estate loans	25,836
Originate consumer, commercial operating and agricultural loans	28,869
Unused lines of credit for consumer use	423,054
Unused lines of credit for commercial use	376,245
Total	$ 1,019,569

At September 30, 2005, the Corporation had $74.0 million in mandatory forward delivery commitments to sell residential mortgage loans. These mandatory forward sales commitments are used by the Corporation to mitigate the interest rate risk associated with commitments to originate mortgage loans for sale in the secondary market and funded mortgage loans held for sale in the secondary market.

The Corporation began selling loans to the FHLB of Topeka (FHLBT) under the Mortgage Partnership Finance Program in 2004. The credit risk associated with these sold loans is structured into various layers. The first layer of losses, after mortgage insurance coverage, is covered by the FHLBT up to 1.0% of the principal amount funded (First Loss Layer). Losses in excess of the First Loss Layer, if any, will be absorbed by the Corporation up to a specified credit enhancement amount which may vary from .25% to 1.5% of the outstanding principal amount of the loans sold. Thereafter, the FHLBT bears the remaining credit risk. In exchange for providing the credit enhancement to the FHLBT, the Corporation receives a credit enhancement fee from the FHLBT. This credit enhancement fee may be reduced by actual losses taken by the FHLBT in the First Loss Layer. As of September 30, 2005, the amount of loans sold to the FHLBT under this program totaled $638.6 million with a maximum credit obligation for potential loan losses to the Corporation totaling $4.4 million. The fair value of this credit obligation was not material at September 30, 2005, since it is highly probable that most credit losses on these loans sold to the FHLBT under this program will be absorbed by the FHLBT in the First Loss Layer.

The parent company provides guarantees of payments of certain amounts (Guaranteed Payments) for the benefit of holders of capital securities issued by Commercial Federal Capital Trust I (Trust I), Commercial Federal Capital Trust II (Trust II) and Commercial Federal Capital Trust III (Trust III), Delaware statutory trusts created by the parent company for the purpose of issuing these capital securities. The Guaranteed Payments are equal to the amount of (i) all accrued and unpaid distributions on the capital securities; (ii) the price payable on redemption of the capital securities; and (iii) upon termination of either Trust I, Trust II or Trust III, the lesser of either the liquidation amount of the respective capital securities and all unpaid distributions thereon, or the amount of assets of Trust I, Trust II or Trust III remaining available for distribution to respective holders after satisfaction of all respective liabilities. The parent company is required to make payments under the guarantees only to the extent that the trusts hold funds sufficient to make such payments, but fail to do so. The maximum potential amount of future payments on these guarantees totals $55.0 million ($10.0 million for Trust I, $25.0 million for Trust II and $20.0 million for Trust III), which is equal to the total principal of the capital securities plus accrued interest. The terms of the guarantees end with the maturities of the respective capital securities, which are October 8, 2033 for Trust I, December 15, 2034 for Trust II and May 23, 2035 for Trust III. The parent company is subrogated to all rights of holders of the capital securities with respect to amounts it pays on the guarantees, which amounts would be recoverable from the funds by the respective trusts. Consequently, the parent company expects that the liquidation of such assets held by the respective trusts would fully cover the maximum potential amount of future payments the parent company may make on the guarantees. The fair values of these guarantees are not material.

Standby letters of credit issued by the Corporation commit the Corporation to make payments on behalf of customers when certain specified future events occur. The credit risk involved with standby letters of credit is primarily the same as the credit risk involved with issuing a loan. At

September 30, 2005 the Corporation had $29.1 million of standby letters of credit with a weighted average term of approximately 22 months. The fees on these standby letters of credit are deferred and recorded at fair value. These fees were not material at September 30, 2005, and no material losses are anticipated from these outstanding standby letters of credit.

The Corporation is a limited partner in several multi-family affordable housing investment properties for which it receives affordable housing tax credits. The Corporation consolidated certain of these partnerships with assets approximating $844,000 as of September 30, 2005 that are included in the accompanying consolidated statement of financial condition. The Corporation has no material potential exposure to loss relative to these partnerships. The consolidation of the remaining partnerships, with assets approximating $336.0 million at September 30, 2005, is not required under the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 46(R). The Corporation s maximum potential exposure to loss from investments in these limited partnerships and unfunded commitments totaled approximately $12.8 million as of September 30, 2005.

H. COMMITMENTS AND CONTINGENCIES (Continued):

The Corporation is also a general partner in numerous limited real estate partnerships formed in prior years to provide investment opportunities for customers of the Bank. The Corporation also holds limited partner interests in certain of these limited partnerships. The consolidation of these limited partnerships is not required under the provisions of FASB Interpretation No. 46(R). Therefore, assets with a net carrying value totaling approximately $16.6 million at September 30, 2005 are not included in the accompanying consolidated statement of financial condition. In the highly unlikely event that all of the assets of these limited partnerships had no value and all other partners failed to meet their obligations, management of the Corporation estimates that its maximum potential exposure to loss would approximate $30.3 million. This amount represents the total liabilities of the limited partnerships for which the Corporation is a general partner plus the net carrying value of the Corporation s investments in these entities at September 30, 2005.

The Corporation is subject to a number of other lawsuits and claims for various amounts which arise out of the normal course of its business. In the opinion of management, the disposition of claims currently pending will not have a material adverse effect on the Corporation s financial position or results of operations.

I. SEGMENT INFORMATION:

The Corporation reorganized its business segments beginning the second quarter of 2005 due to the current year sale of its mortgage servicing rights and broker and correspondent bank mortgage origination network in connection with the Corporation exiting the mortgage loan servicing and wholesale mortgage origination business. The Corporation s operations now consist of three lines of business for management reporting purposes: Commercial Banking, Retail Banking, and Treasury. The previously reported Mortgage Banking segment is now reported as Exited Operations. Secondary marketing functions and servicing activities for Bank-owned loans, which were previously included in the Mortgage Banking segment have been reclassified to the Treasury segment for all reporting periods presented. The financial information presented does not necessarily represent the results of operations or financial condition of these lines of business as if they were independent companies. This information in the following tables is derived from management s internal reporting system used to measure the performance of the segments and the Corporation in total. Therefore, the reported results of operations and financial condition by line of business generated from this management reporting system may not be in accordance with accounting principles generally accepted in the United States. Certain amounts in the prior year periods have been reclassified to conform to the September 30, 2005 presentation for comparative purposes.

The Commercial Banking segment involves the origination of commercial operating loans, commercial and multi-family real estate loans, commercial and residential construction loans, agricultural loans and dealer services. Also included in this segment are commercial demand deposits, as well as cash management products and services. Commercial Banking services are offered through the Bank s branch network, lending offices and the Internet.

The Retail Banking segment involves a variety of traditional banking and financial services. Retail Banking gathers consumer deposits for the Bank to fund the Bank s lending and investment activities. Deposits are obtained by providing a variety of consumer deposit services including consumer checking, savings and certificate of deposit accounts (regular and retirement) and other ancillary deposit-related retail banking services including overdraft protection, electronic and telephone bill-payment and cash withdrawals or transfers. Retail Banking provides services to meet the credit needs of consumers through loans for home equity, small business, autos and other secured and unsecured purposes, including credit cards. Retail Banking originates mortgage loans for the purchase of residential property or to refinance existing debt on residential property. Mortgage loans are sold to the Treasury segment. Loan servicing rights related to all mortgage loans originated by Retail Banking are sold to the Treasury segment. The Retail Banking segment also includes services provided primarily to consumer customers for insurance and securities brokerage services. Retail Banking services are offered and delivered through the Bank s branch network, automated teller machines, customer support telephone centers and the Internet. The Bank also offers these services through network agents located throughout Kansas.

The Treasury segment is responsible for corporate interest rate risk, asset/liability management, the servicing of Bank-owned loans, and the sale of mortgages in the secondary market. Treasury manages the Corporation s single-family residential mortgage loan portfolio, investment and mortgage-backed securities, wholesale deposits, FHLB advances and all other borrowings and absorbs the valuation adjustments related to mortgage servicing rights.

Exited Operations reflect the results of servicing mortgage loans for others which continued until the transfer of the remaining servicing was completed in the 2005 third quarter. Exited Operations encompasses the interim sub servicing of mortgage loans for others until the loan servicing was transferred. Exited Operations (through Mortgage Banking activities) involved the acquisition of selected correspondent and broker mortgage loans, as well as the origination, purchase, and sale of the associated retained rights to service mortgage loans.

Net interest income is determined by the Corporation s internal funds transfer pricing system, which calculates each segment s net interest income contribution based on the type, maturity or repricing characteristics of certain assets and liabilities. The provision for loan losses by segment is based upon the current and historical business cycle loss rates. Total other income consists of revenue directly attributable to each segment and allocations based on segment ownership of certain assets and liabilities. Amortization expense of mortgage servicing rights is charged directly to Exited Operations. Actual valuation adjustments to the mortgage servicing rights portfolio are charged directly to the Treasury segment with allocations made to Exited Operations that related to certain acquisitions of mortgage servicing rights and originations of warehouse mortgage loans. Total other expense consists of direct expenses attributable to each segment and indirect expenses allocated by an activity-based costing system using full absorption.

I. SEGMENT INFORMATION (Continued):

The contribution of the business segments to the consolidated results for the three months ended September 30, 2005 and 2004 is summarized in the following table:

	Commercial Banking	Retail Banking	Treasury and Other	Exited Operations	Consolidated Total
Three Months Ended September 30, 2005:					
Net interest income (loss)	$ 32,690	$ 34,146	$ (107)	$ 778	$ 67,507
Provision for loan losses	4,776	3,102			7,878
Total fee and other income	1,060	29,615	5,780	498	36,953
Total other expense	9,547	50,059	2,684	3,665	65,955
Income (loss) before income taxes	19,427	10,600	2,989	(2,389)	30,627
Income tax provision (benefit)	6,897	3,763	(2,222)	(848)	7,590
Net income (loss)	$ 12,530	$ 6,837	$ 5,211	$ (1,541)	$ 23,037
Total net interest and other income	$ 33,750	$ 63,761	$ 5,673	$ 1,276	$ 104,460
Intersegment revenue		3,391	660	526	
Depreciation and amortization	112	2,081	2,035	13	4,241
Total assets	4,445,732	1,493,305	4,180,576	44,911	10,164,524
Three Months Ended September 30, 2004:					
Net interest income	$ 30,475	$ 27,484	$ 5,399	$ 731	$ 64,089
Provision for loan losses	2,861				