FDIC State Profile

Summer 2005

Arizona

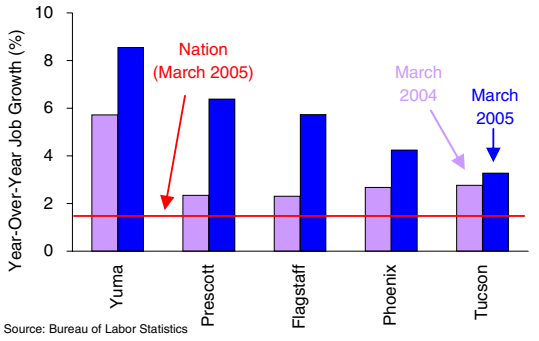
Arizona reported a strong start to 2005 with 4.1 percent job growth, ranking second nationwide.

- The Arizona retail trade and construction sectors were the strongest contributors to employment growth, closely followed by business services and education and health services. Together, these sectors added more than two thirds of the state's net new jobs. Job growth is expected to remain strong in 2005 but moderate in 2006.[1]
- While the majority of new jobs were created in the **Phoenix** area, job gains were widespread throughout most of the state (See Chart 1).
- The Department of Defense's Base Realignment and Closure (BRAC) recommendations announced in May 2005 include seven of the state's military facilities, five of which could experience a net loss in staff. Although affected bases include Fort Huachuca and Luke Air Force Base, both among the state's top 20 employers, statewide BRAC-related net job losses may be limited to only 550 positions.

Commercial real estate (CRE) fundamentals improved but institution exposures remained high.

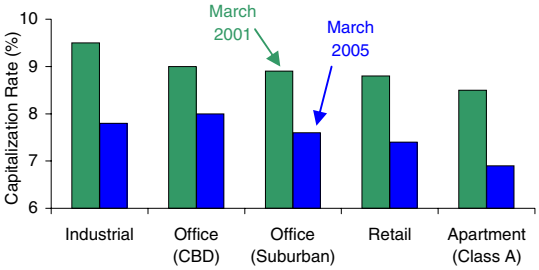
- Job growth and in-migration continued to benefit the Phoenix and **Tucson** markets as vacancy rates and rents improved year-over-year across most property types.
- Declining capitalization rates over the past few years have contributed to rising commercial property values in Phoenix (See Chart 2). However, any increases in interest rates have the potential to pressure capitalization rates and property values prospectively, all else equal.
- Tucson- and Phoenix-based insured institutions continue to report elevated concentrations of CRE loans[2]-to-Tier 1 capital, ranking 1st and 43rd among larger metropolitan areas, respectively. Statewide, Arizona's median CRE loan-to-Tier 1 capital ranked third in the nation behind Nevada and California.

Chart 1: Every Arizona Metropolitan Area Reported Job Growth Faster Than the National Average



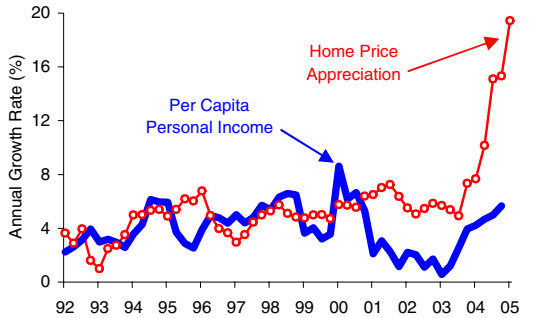
Source: Bureau of Labor Statistics

Chart 2: Capitalization Rates Declined Across All Commercial Property Types in Phoenix



Note: CBD is central business district.
Source: Data provided by the National Real Estate Index/Global Real Analytics, (800) 992-7257

Chart 3: The Gap Between Arizona Home Price Appreciation and Income Growth Widened



Source: Bureau of Economic Analysis, Office of Federal Housing Enterprise Oversight

[1] Forecast from Economy.com and University of Arizona Economic and Business Research Center.
[2] Commercial real estate loans include construction, multifamily, and nonfarm-nonresidential mortgages.

Construction loan portfolios have grown along with the strong housing market.

- Arizona annual home price gains accelerated in first quarter 2005 to 19.4 percent, the fastest pace since 1979.
- Arizona homes remain relatively affordable but the gap between income growth and home price appreciation has increased since the 1990s and may make it difficult for buyers to purchase more expensive homes (See Chart 3).
- **Yuma**, **Flagstaff**, Phoenix, and **Prescott** reported the strongest rates of home price appreciation (See Map 1).
- Speculative transactions may be contributing to price gains. DataQuick Information Systems estimates that investors who re-sold homes within six months accounted for 5.2 percent of recent transactions in Phoenix, versus 2.9 percent 5 years ago, and 3.7 percent nationwide.[3]
- Annual mortgage loan growth among Arizona-based insured institutions was strong at 23 percent, but construction and development (C&D) mortgages grew by a larger magnitude. As a result, C&D loans likely represent a larger source of housing-related credit risk than traditional mortgages (See Chart 4).[4] At 160 percent, Arizona-based institutions reported the highest median C&D loan-to-Tier 1 capital in the nation.

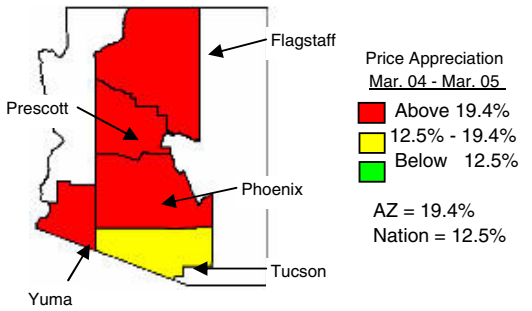
Growing net interest margins lifted earnings.

- Annualized year-to-date pre-tax return on assets reached 1.40 percent on a median basis in March 2005, representing the strongest first quarter performance for Arizona-based insured institutions since 1999 and comparable to the national median of 1.39 percent.
- Earnings were buoyed by stronger net interest income and lower relative overhead burdens (See Chart 5). The commercial focus of bank loan portfolios enabled asset yields to respond more quickly than funding costs to rising short-term interest rates.

Asset quality remained strong but some signs of seasoning have emerged.

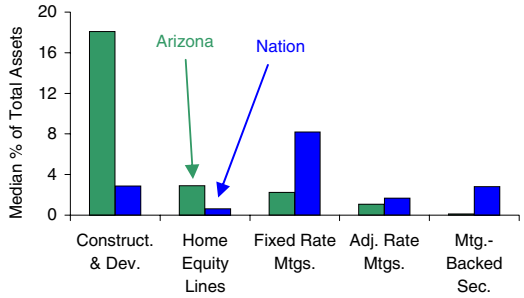
- The relative level of past-due total loans reported by Arizona-based institutions ranked lowest among the 50 states and DC, helped by strong job conditions, relatively low interest rates, and the fast-growing, unseasoned nature of loan portfolios. Newer loans typically exhibit lower default activity. Additional credit seasoning among the state's young institutions may pressure credit quality.
- Although overall delinquency ratios declined, institutions open at least three years reported a year-over-year doubling of the median past-due rates on consumer and commercial and industrial loans to 0.35 percent and 0.87 percent, respectively.
- Total loan growth, which remained the fastest nationally, outpaced loan loss reserve increases, further pressuring the median loan loss reserve-to-total loans ratio.

Map 1: Yuma, Flagstaff, Phoenix, and Prescott all Reported Fast Home Price Appreciation



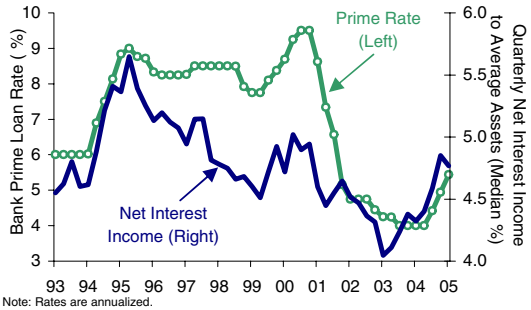
Source: Office of Federal Housing Enterprise Oversight

Chart 4: Housing Market Exposures Among Arizona Banks Center in Construction Loans



Source: FDIC (Call Report filers only, data as of March 31, 2005)

Chart 5: Rising Short Term Interest Rates Lifted Quarterly Margins Among Arizona-Based Banks



Note: Rates are annualized.
Sources: FDIC; Federal Reserve

[3]Sue Kirchhoff, "Home Prices in Metro Areas Soar," USA Today, May 22, 2005.
[4]Because of Call Report and Thrift Financial Report data limitations, the proportion of construction and development mortgages related to single-family building is unknown.

Arizona at a Glance

ECONOMIC INDICATORS (Change from year ago quarter, unless noted)

Employment Growth Rates	Q1-05	Q1-04	Q1-03	Q1-02	Q1-01
Total Nonfarm (share of trailing four quarter employment in parentheses)	4.1%	2.6%	1.1%	-0.9%	2.4%
Manufacturing (7%)	0.7%	-0.7%	-5.7%	-10.1%	0.4%
Other (non-manufacturing) Goods-Producing (8%)	10.3%	6.2%	0.3%	-1.1%	4.6%
Private Service-Producing (67%)	4.1%	3.2%	1.9%	-0.6%	2.5%
Government (17%)	2.9%	0.6%	1.9%	3.5%	2.5%
Unemployment Rate (% of labor force)	4.4	5.2	5.8	5.9	4.1

Other Indicators	Q1-05	Q1-04	Q1-03	Q1-02	Q1-01
Personal Income	N/A	6.9%	3.2%	4.9%	4.8%
Single-Family Home Permits	8.5%	23.9%	11.6%	2.1%	-0.4%
Multifamily Building Permits	70.0%	41.1%	-3.2%	-63.5%	-21.6%
Existing Home Sales	13.8%	22.0%	11.5%	8.2%	9.6%
Home Price Index	19.4%	7.7%	5.7%	5.5%	6.5%
Bankruptcy Filings per 1000 people (quarterly level)	1.27	1.35	1.33	1.20	1.09

BANKING TRENDS

General Information	Q1-05	Q1-04	Q1-03	Q1-02	Q1-01
Institutions (#)	51	49	49	44	48
Total Assets (in millions)	69,861	49,570	49,916	42,727	63,905
New Institutions (# < 3 years)	12	13	15	12	16
Subchapter S Institutions	7	6	5	3	2

Asset Quality	Q1-05	Q1-04	Q1-03	Q1-02	Q1-01
Past-Due and Nonaccrual Loans / Total Loans (median %)	0.40	0.58	0.56	1.05	0.87
ALLL/Total Loans (median %)	1.08	1.10	1.21	1.36	1.33
ALLL/Noncurrent Loans (median multiple)	4.36	3.36	2.71	2.20	2.83
Net Loan Losses / Total Loans (median %)	0.00	0.00	0.00	0.02	0.03

Capital / Earnings	Q1-05	Q1-04	Q1-03	Q1-02	Q1-01
Tier 1 Leverage (median %)	9.78	9.96	9.60	9.41	8.72
Return on Assets (median %)	0.84	0.87	1.04	1.09	0.99
Pretax Return on Assets (median %)	1.14	1.23	1.10	1.40	1.53
Net Interest Margin (median %)	5.52	5.22	5.26	5.56	5.64
Yield on Earning Assets (median %)	7.47	7.35	7.45	8.10	8.79
Cost of Funding Earning Assets (median %)	2.02	2.02	2.22	2.62	3.11
Provisions to Avg. Assets (median %)	0.32	0.35	0.31	0.31	0.30
Noninterest Income to Avg. Assets (median %)	0.59	0.61	0.67	0.67	0.67
Overhead to Avg. Assets (median %)	4.56	4.79	4.34	4.51	4.38

Liquidity / Sensitivity	Q1-05	Q1-04	Q1-03	Q1-02	Q1-01
Loans to Assets (median %)	74.6	73.1	68.3	68.5	65.1
Noncore Funding to Assets (median %)	14.8	16.4	18.2	14.0	16.1
Long-term Assets to Assets (median %, call filers)	4.6	7.1	8.7	5.4	6.8
Brokered Deposits (number of institutions)	26	21	22	15	14
Brokered Deposits to Assets (median % for those above)	7.2	7.1	8.1	15.0	9.0

Loan Concentrations (median % of Tier 1 Capital)	Q1-05	Q1-04	Q1-03	Q1-02	Q1-01
Commercial and Industrial	112.2	100.9	98.1	121.9	133.0
Commercial Real Estate	443.4	399.4	350.5	389.6	245.5
Construction & Development	160.0	102.8	85.3	104.2	82.4
Multifamily Residential Real Estate	5.7	3.8	4.5	4.3	3.4
Nonresidential Real Estate	255.7	241.9	230.0	253.4	123.5
Residential Real Estate	81.5	78.0	79.3	77.0	72.0
Consumer	10.6	11.9	15.5	18.0	23.8
Agriculture	0.2	0.0	0.0	0.2	0.0

BANKING PROFILE

Largest Deposit Markets	Institutions in Market	Deposits ($ millions)
Phoenix-Mesa-Scottsdale, AZ	63	43,717
Tucson, AZ	19	8,941
Prescott, AZ	11	2,472
Yuma, AZ	9	1,111
Flagstaff, AZ	8	783

Asset Distribution	Institutions
< $250 million	39 (76.5%)
$250 million to $1 billion	7 (13.7%)
$1 billion to $10 billion	4 (7.8%)
> $10 billion	1 (2%)