

PUBLIC DISCLOSURE

September 20, 1999

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**Western Security Bank
999663
7401 East Camelback Road
Scottsdale, Arizona 85251**

**Federal Reserve Bank of San Francisco
101 Market Street
San Francisco, California 94105**

Note: This evaluation is not, nor should it be construed as, an assessment of the financial condition of this institution. The rating assigned to this institution does not represent an analysis, conclusion or opinion of the federal financial supervisory agency concerning the safety and soundness of this financial institution.

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GENERAL INFORMATION

The Community Reinvestment Act (CRA) requires each federal financial supervisory agency to use its authority when examining financial institutions subject to its supervision to assess the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation of the institution. Upon conclusion of such examination, the agency must prepare a written evaluation of the institution's record of meeting the credit needs of its community.

*This document is an evaluation of the CRA performance for **Western Security Bank** prepared by the **Federal Reserve Bank of San Francisco**, the institution's supervisory agency, as of **September 20, 1999**. The agency rates the CRA performance of an institution consistent with the provisions set forth in Appendix A to 12 CFR Part 228.*

Institution's CRA Rating: This institution is rated satisfactory.

The bank's overall performance under the Community Reinvestment Act remains satisfactory. The geographic distribution of lending shows an adequate penetration in all types of census tracts found in the bank's assessment area. In addition, lending to businesses of different sizes and borrowers of different incomes is adequate when compared to the assessment area demographics and credit needs. While the bank's loan-to-deposit ratio clearly demonstrates a willingness and ability to lend, a majority of its lending occurred outside of the bank's defined assessment area, primarily as a result of the bank's consumer construction lending. Although declining during the review period, a majority of both small business and consumer installment lending was within the bank's assessment area. Although the level of lending inside the assessment area needs improvement, it is not so low that it results in an overall "needs to improve" CRA rating. Currently, lending levels within the assessment area remain sufficient to assess the bank's record under the other lending criterion mentioned above.

PERFORMANCE CONTEXT

Description of Institution

Western Security Bank, a wholly owned subsidiary of Western Security Holding Company is headquartered in Scottsdale, Arizona with three branches located in the city of Scottsdale. The main office is located in central Scottsdale, with two branches located in the Scottsdale Airpark. The newest branch, Greenway, opened in May 1999 during this review period. The main office and the Greenway branch are full service offices offering loan products, deposit services, and “in-house” processing of loan applications. The Raintree office, however, does not have a loan officer and accepts loan applications that are processed through the Greenway branch.

The bank has recently experienced growth, both in terms of its asset size and its branching network. According to the bank’s Consolidated Reports of Condition and Income (Call Report) assets totaled \$87.4 million as of June 30, 1999, a 26 percent increase since that same time period in 1998. The bank’s loan portfolio as of June 30, 1999, had the following distribution:

Loan Type	Percent of Total Loans (Dollar Amount)
Construction & Land Development	58.3
Commercial / Industrial and Nonfarm Nonresidential Real Estate	32.8
Consumer	5.1
Secured by 1-4 Family Residential Real Estate	3.8
Total	100.0

The table above indicates that the bank is primarily a construction and commercial lender. Although the bank has traditionally had a strong commercial lending focus, trends over the past five years show that the proportion of construction lending continues to increase. The bank’s construction lending is mostly owner-occupied residential real estate for individuals have their own home built. Recent growth in the Phoenix metropolitan area has resulted in a relatively strong economy that has created increased demand for construction loans.

Consistent with these lending trends, the bank’s strategy is to continue addressing the housing needs of the area via its consumer construction lending. Additionally, the bank strives to provide banking services of all types to Scottsdale’s small to mid-sized businesses. The placement of two branches in the Scottsdale Airpark is in large part due to the bank’s desire to increase emphasis in the city of Scottsdale and on its commercial lending products.

Although the bank is situated in a competitive banking environment, there are no legal or financial impediments that would prevent the bank from meeting the community’s credit needs consistent with its size, resources, financial capacity, and local economic conditions. At its previous examination, the bank’s CRA performance was rated satisfactory.

Description of Assessment Area

The bank's current assessment area is the city of Scottsdale in its entirety, which is located in eastern Maricopa County. As of the 1990 census, Scottsdale has a population of 133,993. It covers approximately 184 square miles, and has 30 census tracts, none of which are low-income. The following table shows the distribution of tracts, population, and families by income level that were used to develop the context for the performance evaluation.

Income Level	Low	Moderate	Middle	Upper
Census Tract	0	3%	30%	67%
Population by Census Tract Level	0	4%	31%	65%
Family Distribution	12%	12%	19%	57%

Considered a relatively affluent section of Maricopa County, the median family income for Scottsdale is \$48,197, which is significantly higher than the same figure for the county (\$35,425), as well as for the state (\$32,178). Recently, however, Scottsdale has evolved from a bedroom community to a net importer of employees, with job growth exceeding the labor force. Over the last two years, 25 companies have moved or expanded into Scottsdale, adding over 4,500 new jobs to the market.¹

Consistent with this job growth and the overall healthy economy in the county, the 1998 average annual unemployment rate for the bank's assessment area is low at 1.9 percent. Similarly, the unemployment rate for the Metro Phoenix area is also low at 2.6 percent when compared to the state at 4.1 percent.² As of 1996, the largest employment category for the county by industry was services, followed by retail and wholesale trade, due in large part to the level of tourism in the area. In that regard, Scottsdale's employment sectors are similar to the county. The county's largest employment growth between 1993 and 1996, however, has been in the construction industry.³ Western Security Bank's increased residential construction lending is a reflection of the demand for lending resulting from the growth in the construction industry. Although experiencing growth in construction, Scottsdale has not seen the same level of growth as have other portions of the county.

The trends in Scottsdale's business and industry have changed in recent years. Currently, climate (a major influence on the tourism industry) continues to be a major economic factor in Scottsdale. The new economic drivers in the area, however, are high technology, research and development, manufacturing, and bio-medical. The strength of the tourism industry is the main reason why the city of Scottsdale historically has not been as impacted by economic slowdowns as have other communities. Tourism is expected to remain strong, which in turn should reflect strong tourist-oriented sales. The other economic drivers noted above, however, have resulted in many new health care centers and businesses moving to Scottsdale, thereby resulting in an economy that is not as reliant on tourism.⁴

¹ SOURCE: Office of Economic Development – April 1999

² SOURCE: Office Of Economic Development – April 1999

³ SOURCE: Regional Economic Information System (REIS)

⁴ SOURCE: Scottsdale Chamber of Commerce.

Data provided by Dun and Bradstreet (a firm that provides business and credit data) show that 8,610 or 85 percent of the total businesses operating within the bank's defined assessment area have gross annual sales of \$1 million or less.⁵ The geographic distribution these businesses is two percent in moderate-income areas, 28 percent in middle-income areas, and 70 percent in upper-income areas. According to contacts within the community needs exist for micro loans to small businesses and small business technical assistance regarding the development of business plans and completion of loan applications.

With regard to consumer credit needs in the assessment area, affordable housing loan programs are consistently stated by community contacts as a need. The bank, however, is not a mortgage lender and unable to directly address this need.

⁵ These are considered "small businesses" for purposes of the CRA regulation.

CONCLUSIONS WITH RESPECT TO PERFORMANCE CRITERIA

Scope of Examination

Western Security Bank's performance under the Community Reinvestment Act was evaluated based upon four of the five performance criteria for small banks. These include loan volume in comparison to deposits (Loan-to-Deposit Ratio), lending inside and outside the assessment area (Lending in Assessment Area), the distribution of lending to borrowers of different income levels and to businesses of different sizes (Lending by Borrower Income and by Business Revenue), and lending dispersion throughout the census tracts within the assessment area (Geographic Distribution of Loans). The bank's responsiveness to consumer complaints was not evaluated because no CRA-related complaints were received since the bank's previous CRA examination.

To evaluate the bank's CRA performance 385 consumer construction, 226 consumer installment, and 153 small business loans extended from January 1998 through June 1999 were reviewed. These loans were first analyzed to determine the volume of lending within the bank's assessment area. Those loans extended within the assessment area were then used to evaluate the bank's geographic distribution of lending. To evaluate the bank's lending by business revenue and borrower income, revenue and income data was collected for a random sample of 134 consumer installment, 94 small business and 40 consumer construction loans extended inside the bank's assessment area. By utilizing only those loans extended inside of the bank's assessment area, examiners evaluated the bank's record of meeting the credit needs of its designated community.

Loan-to-Deposit Ratio

Western Security Bank's loan-to-deposit ratio exceeds standards for satisfactory performance. This conclusion is primarily based on the fact that the bank has a relatively high ratio in comparison to national, state, and local peer banks.

Specifically, the bank's average loan-to-deposit ratio for the eight quarters of September 1997 through June 1999 is 77.8 percent. During the same time period, local peer bank average loan-to-deposit ratios ranged from 62.1 percent to 73.6 percent while the state average was 71.7 percent and its national peer banks were 71.1 percent.

Lending in Assessment Area

The bank's level of lending inside its defined assessment area does not meet standards for a satisfactory performance. The table below shows that although a majority of the bank's small business and consumer installment loans were extended inside its assessment area, a significant majority of the bank's consumer construction loans were made outside of the assessment area.

Loan Type	Number of Loans		Dollar Amount of Loans	
	Percent Inside	Percent Outside	Percent Inside	Percent Outside
Small Business	62%	38%	64%	36%
Consumer Construction	11%	89%	16%	84%
Consumer Installment	59%	41%	38%	62%
Total	35%	65%	24%	76%

Due to the high volume of construction lending, the overall majority of loans also were made outside of the assessment area. As noted in the Performance Context, this level of construction lending can, at least partially, be attributed to the fact that more building permits are issued and more construction is occurring outside of Scottsdale than is occurring inside. Nevertheless, at just 11 percent within the assessment area, this level of lending is not consistent with a satisfactory performance.

Additionally, although a majority of small business and consumer installment loans were made inside the assessment area, the level of assessment area lending for these two products did decrease during the review period. Nevertheless, as previously stated, the level of lending inside the assessment area remains sufficient to assess the bank's record of lending within the assessment area.

Lending by Borrower Income and By Business Revenue

The bank's distribution of loans to businesses of different sizes and to borrowers of different income levels meets standards for a satisfactory performance when considered in light of the bank's performance context.

In comparing its lending performance to the credit needs of its assessment area the bank has made a reasonable amount of loans to small businesses. Of the 94 small business loans sampled, 73 percent were extended to small businesses, which compares reasonably to the 85 percent concentration of small businesses in the assessment area. Moreover, 82 percent of the loans extended to small businesses were in amounts of \$100,000 or less. The number of loans extended to small businesses in these small amounts confirms the bank's responsiveness in addressing the more critical small business needs in the community.

The bank's performance with regard to consumer construction lending is reasonable based on the fact that it is very difficult for low- and moderate-income borrowers to participate in Scottsdale's housing market due to the high cost of housing and a comparatively low owner-occupancy rate at just 54 percent. With regard to consumer installment lending, the bank's lending patterns compare very favorably with the distribution of assessment area families, with a significant level of lending to low- and moderate-income borrowers. The table below shows the bank's consumer construction and consumer installment lending performance as compared to the distribution of families in the assessment area.

	Low- Income	Moderate- Income	Middle- Income	Upper- Income
Consumer Construction	3%	0%	10%	87%
Consumer Installment	13%	10%	11%	25%
Families in Assessment Area	12%	12%	19%	57%

Geographic Distribution of Loans

The geographic distribution of the bank's small business, construction, and consumer lending reflects an adequate dispersion throughout the assessment area.

Western Security Bank's assessment area is comprised mainly of upper-income census tracts, followed by middle-income census tracts, with just one moderate-income census tract and no low-income census tracts. Consistent with the tract distribution, many of the businesses and much of the population also are located in upper-income census tracts. While the middle-income and upper-income census tracts are evenly distributed throughout the assessment area, the only moderate-income tract is located in the southwest corner of the assessment area. Two of the bank's offices are located in upper-income census tracts and one is located in a middle-income census tract.

The table below portrays the bank's dispersion of small business loans within the various income geographies.

	Moderate – Income	Middle- Income	Upper- Income
Number of Small Business Loans	9%	34%	57%
Distribution of Businesses	2%	28%	70%
Aggregate Small Business Lending⁶	1%	20%	79%
Census Tracts in Assessment Area	3%	30%	67%

The bank's small business lending, particularly in moderate-income geographies, reflects a strong performance compared to the distribution of small businesses as well in comparison to other lenders in the market.

The table below shows the bank's distribution of consumer construction and consumer installment loans within the different income geographies. As shown in the table, the bank's consumer lending compares favorably to assessment area geographies, regardless of income level.

⁶ Aggregate small business lending is the total number of small business loans extended during 1998 in the area by large financial institutions required to collect and report loan data for CRA purposes.

	Moderate- Income	Middle – Income	Upper – Income
Consumer Construction Lending	3%	2%	95%
Consumer Installment Lending	4%	23%	73%
Census Tracts in Assessment Area	3%	30%	67%

As noted above, the distribution of small business, construction, and installment loans is reflective of the income geographies in the bank’s assessment area and is considered reasonable.

Response to Complaints

The bank’s responsiveness to consumer complaints was not evaluated because no CRA-related complaints have been received since the previous examination.

Compliance with Fair Lending Laws and Regulations

No violations of the substantive provisions of the anti-discrimination laws and regulations were identified at this examination. The bank has policies, procedures, and training programs in place that are designed to facilitate compliance with fair lending laws and regulations.