



**SMALL BANK**

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Comptroller of the Currency  
Administrator of National Banks  
Washington, DC 20219

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## **PUBLIC DISCLOSURE**

**April 10, 2006**

### **COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION**

**Stearns Bank Arizona, N.A.  
Charter Number 23932**

**9225 East Shea Boulevard  
Scottsdale, AZ 85260**

**Comptroller of the Currency  
North Dakota & NW Minnesota  
3211 Fiechtner Drive, SW  
Fargo, ND 58103**

**NOTE: This document is an evaluation of this 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. 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.**

**INSTITUTION'S CRA RATING:** This institution is rated Satisfactory.

Stearns Bank Arizona, N.A. has a satisfactory record of meeting the credit needs of its assessment area (AA) based on the following:

- The loan-to-deposit (LTD) ratio meets the standards for a satisfactory rating.
- The bank's level of lending within the AA is good.
- The distribution of loans to businesses of different sizes is good based on bank and affiliate lending to businesses with revenues of \$ 1 million or less and in financing affordable housing construction.
- The geographic distribution of loans to businesses is good based on bank lending and affiliate lending in low- and moderate-income geographies, which resulted in permanent job creation and affordable housing construction.
- Community development lending and services enhanced bank performance.

**DESCRIPTION OF INSTITUTION:**

Stearns Bank Arizona, N.A. (SBAZ) is one of five affiliates under Stearns Financial Services, Inc. (SFS), and the only affiliate located outside of the state of Minnesota. Loans are generated on behalf of SBAZ through the company affiliate Stearns Bank N.A. (SBNA), located in St. Cloud, MN. Those loans are generated on a national level, primarily in construction, SBA, USDA, Partnership, Factoring, and Section 42 products.

SBAZ converted to a national bank charter on October 8, 1999. The bank was originally opened as a state bank in September 1997. SBAZ is 100% owned by Stearns Financial Services, Inc. (SFS), St. Cloud, Minnesota, a \$1.5 billion holding company with three national banks in Minnesota. SFS's primary shareholders are Norman C. Skalicky and an employee stock ownership plan. SBAZ's total assets were \$194 million as of December 31, 2005. The bank's last CRA examination was on October 2, 2000, when it was rated Satisfactory.

SBAZ office is located in the northeast section of Maricopa County in the city of Scottsdale, Arizona. The bank has 41 employees, including five employees with lending authority within the institution and President/COO Tom Euen, who has been with the bank since February 17, 2000.

SBAZ is a business-oriented bank with a strong emphasis on real estate acquisition and development lending. Products offered include commercial, commercial real estate, and construction/development loans. Consumer and residential products are incidental to SBAZ's business. The bank is a Preferred Small Business Administration (SBA) lender and originated more than \$34 million in SBA loans during the evaluation period. SBA Business Development Officer Janet Sullivan is currently in charge of bringing in SBA loans. However, during the evaluation period, SBAZ operated without an officer in this capacity due to conditions beyond management's control. Given the bank's business emphasis, consumer and residential loans were not reviewed during this examination.

The majority of the bank's loan portfolio is concentrated in construction and development loans of \$86.5 million (59.9%), commercial real estate loans of \$45.8 million (31.7%), and commercial and industrial loans of \$9.9 million (6.9%). The combined residential real estate, consumer, and other loans total \$2.1 million (1.5%).

SBAZ's financial condition is satisfactory and does not hinder its ability to service customer needs. Factors that impacted the bank's ability to make loans to small businesses and to penetrate its entire assessment area include its small asset size, single office location, and strong competition for small loans to businesses, including low documentation products originated by some of the largest banks in the country.

## **DESCRIPTION OF MARICOPA COUNTY ASSESMENT AREA:**

The Metropolitan Statistical Area (MSA) is comprised the Maricopa and Pinal Counties; however SBAZ's assessment area (AA) is Maricopa County, Arizona only. The AA is comprised of 663 census tracts (CTs). Six percent of those CTs are designated as low-income and 27 percent are designated as moderate-income. The total population in Maricopa County is reported at more than 3 million in the 2000 census. The AA meets the requirements of the regulation and does not arbitrarily exclude low- and moderate-income geographies.

The largest employers are government, Banner Health Systems, Motorola, Wal-Mart, Honeywell, Krogers Grocery, and Intel. The area is also highly dependent on tourism. The MSA unemployment rate is 4%. The 2005 HUD Updated MSA Median Family Income for the area is \$58,300, with the median single-family home costing \$268 thousand. The local economy is robust with jobs, income and population expanding rapidly according to a December 2005 Moody's Economic.com report. One disadvantage of the recent boom has been the high and rising cost of living, including the price of housing.

Competition for financial services is strong in Maricopa County, with the banking market dominated by three large multi-state institutions delivering banking services through an extensive retail network. These three institutions control 67 percent of the deposit base in Maricopa County. There are 64 other institutions operating within the AA, for a total of 718 offices. These competitors range in size from \$1.6 million to \$13 billion inside the market area. SBAZ has 0.26 percent of deposits. SBAZ's location in a middle income CT, its single office, and its commercial real estate market niche all hinder its ability to capture a larger percentage of small business lending in the market.

Information from community contacts reveals that credit needs in the AA include small business and affordable housing lending. Increasing loan demand is evidenced by a number of new banks being established in the AA.

## **CONCLUSIONS ABOUT PERFORMANCE CRITERIA:**

Our evaluation was based on a random sample of commercial and commercial real estate loan originations in 2004, 2005 and the first two months of 2006. In all, 66 loans were reviewed. A significant portion of the sample consisted of loans to shell entities that were created to acquire or develop commercial real estate. The majority of these shell entities reported no business revenues because repayment of the loans is to come from the sale or take-out financing of the real estate. Many of the shell entities consisted of limited liability companies (LLCs) that are owned by individuals, other LLCs, partnerships or other businesses upon which the bank relied to reach a credit decision, rather than the revenues of the shell entities.

In addition and at SBAZ's request, we considered information on affiliate lending in the bank's assessment area. Detailed information was provided on equipment leases/purchase contracts, factoring financing, SBA lending and affordable housing loans originated by affiliates on behalf of the bank during the evaluation period.

**Loan-to-Deposit Ratio**

The bank's loan-to-deposit ratio (LTD) meets the standards for satisfactory performance. SBAZ's level of lending is satisfactory in relation to other banks under \$200 million in Maricopa County. The bank's average LTD ratio for the last 20 quarters was 90%, as compared to a 96% average LTD ratio for similar size banks in Maricopa County. SBAZ's LTD ratio was 85% as of December 31, 2005.

**Lending in Assessment Area**

The bank's level of lending within its assessment area is good. Using the 66 small business loans in our sample, we determined the level of loans made within the bank's AA. Overall, 91% of the number and 98% of the dollar of loans in our sample were originated within the bank's AA.

**Lending to Borrowers of Different Incomes and to Businesses of Different Sizes**

- The distribution of the bank's direct lending to businesses of different sizes is poor; however,
- Affiliate lending that is responsive to small businesses and affordable housing construction enhanced the bank's direct lending.

Using our sample of 60 commercial and commercial real estate loans originated inside the AA, we verified the accuracy of information provided by the bank to determine the business revenue size relative to the borrowers. The chart below reflects the distribution of loans by business revenue size.

<b>Borrower Distribution of Loans to Business in Maricopa County</b>			
<b>Business Revenues</b>	<b>≤ \$1,000,000</b>	<b>&gt; \$1,000,000</b>	<b>Not Applicable</b>
<b>% of AA Businesses*</b>	61%	6%	33%
<b>% of Bank Loans in AA by #</b>	28%	25%	47%
<b>% of Bank Loans in AA by \$</b>	11%	31%	57%

Our analysis indicates that 28% of the number of loans was granted to businesses with revenues of \$1 million or less. This performance compares unfavorably to the percentage of business that have similar revenues in the AA. This is partially because for approximately 47% of the loans in our sample, gross revenues of the borrower were not used in the credit decision and are shown as unknown in the chart above. Management believes that various factors hindered the bank's performance, including heavy competition from other lenders, limited delivery systems, and the unforeseen absence of SBAZ's SBA lender. Nonetheless, the performance is significantly enhanced by the volume and nature of affiliate lending that occurred in the AA during the evaluation period.

SBNA participates in SBA lending on a national level. Not included in the table below are SBA loans

originated by the affiliate in the bank’s AA that enhanced SBZ’s performance. During the evaluation period, SBNA originated eight SBA loans to businesses with revenues of \$1 million or less, totaling \$565,000.

SFS provides working capital financing to small businesses across the nation. This type of financing is important to small businesses that do not have other collateral to pledge, providing cash flow for operations. This affiliate lending had a positive impact on the bank’s performance. Since its formation in 2003, SFS’s Factoring Division originated 18 loans in the AA totaling \$20,878,500. Of these loans, 14 (78%) were in amounts of \$1 million or less and seven (39%) funded businesses with revenues of \$1 million or less.

SBNA is active in the Section 42 lending market, working with residential affordable housing developers. Positive consideration was given for affordable housing projects funded by SBNA in the AA. During the evaluation period, SBNA originated three construction loans totaling more than \$7 million that ultimately created 496 affordable housing units. The viability of each of these projects was enhanced by low-income housing tax credits (LIHTCs).

**Geographic Distribution of Loans**

- The geographic distribution of the bank’s direct lending to businesses is poor; however,
- Affiliate lending that is targeted to low- and moderate-income geographies and is responsive to small businesses development and permanent job creation enhanced the bank’s performance.

We sampled 60 small business loans to determine the geographic distribution of loans in the bank’s AA. The following table reflects the distribution of small business loans by census tract.

<b>Geographic Distribution of Loans to Small Businesses</b>								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan Type	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans
Commercial/ Commercial Real Estate	6%	0%	24%	10%	32%	37%	38%	53%

A comparison of the geographic distribution of the bank’s small business lending to the percentage of businesses in low- and moderate-income geographies above indicates poor performance. However, the performance is enhanced by the volume of affiliate lending that occurred in the AA during the evaluation period.

SBNA provides an innovative commercial equipment leasing program to small businesses across the nation. The bank’s performance was enhanced by lease/purchase contracts originated in Maricopa County. During the evaluation period, the Leasing Division of SBNA originated 113 lease/purchase equipment contracts totaling \$3,454,032. Thirteen (12%) of these equipment contracts totaling \$240,455 were in low-income geographies and 37 (34%) totaling \$1,198,722, were in moderate-

income geographies.

SFS makes construction loans with takeout commitments on a national basis under its Partnership Lending Program. Since 2003, SFS's Partnership Lending Division originated seven SBA 504 loans totaling approximately \$14 million. Of this volume, three (43%) resulted in permanent job creation in moderate-income geographies. Positive consideration was given for this partnership lending.

As described above, positive consideration was also given for affordable housing projects funded by SBNA in the AA. During the evaluation period, SBNA originated three LIHTC-enhanced construction loans, two of which were projects in moderate-income geographies that created 352 affordable housing units.

### **Qualified Loans, Investments, and CD Services**

- Community development lending and services enhanced bank performance.

SBAZ originated a \$3,529,700 community development loan to purchase and develop a 65.3 acre parcel of land for industrial office condos and a multi-cultural event facility. The site, which is located in a low-income geography, had been used as a sand, gravel and rock pit until 1991 when it became an inert debris landfill. The area, which is now targeted for revitalization by the City of Phoenix, has received federal and local funding. The parcel of land that will benefit from the bank's loan will serve as a gateway to the transformed 580 acres of The Rio Salado Ranch. This community development loan is highly responsive to local credit needs because it will revitalize a depressed area targeted by the community. It is complex because special consideration had to be given to structural support for proposed buildings that will be located on what was previously debris landfill with environmental issues.

SBAZ regularly provides free office space for counselors from SCORE, Counselors to Arizona's Small Business, to meet with its clients. The bank's SBA Business Development Officer also provides community development services to small business owners regularly. In quarterly presentations offered to SCORE and Community Development Corporation attendees (primarily sole proprietors, small business owners, and individuals with entrepreneurial aspirations), financial education is provided. Topics include:

- How to prepare a complete loan package and what to include,
- Loan requirements based on loan type,
- Standard loan structures and terms,
- Differences in loan types offered by banks versus SBA, and
- Individualized counseling and advice on loan request packages and loan types.

This officer makes similar presentations to business students, small business groups, local chambers of commerce and trade groups.

### **Responses to Complaints**

SBAZ did not receive any CRA related complaints during the evaluation period.

## **RECORD OF COMPLIANCE WITH ANTI-DISCRIMINATION LAW**

### **Fair Lending or Other Illegal Credit Practices Review**

We found no evidence of illegal discrimination or other illegal credit practices.