

MID AMERICA APARTMENT COMMUNITIES INC

Form 10-Q

November 06, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2008

or

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

For the transition period from to _____

Commission File Number: 1-12762

MID-AMERICA APARTMENT COMMUNITIES, INC.
(Exact name of registrant as specified in its charter)

TENNESSEE
(State or other jurisdiction of
incorporation or organization)

62-1543819
(I.R.S. Employer Identification No.)

6584 POPLAR AVENUE, SUITE 300
MEMPHIS, TENNESSEE
(Address of principal executive offices)

38138
(Zip Code)

(901) 682-6600
(Registrant's telephone number, including area code)

N/A
(Former name, former address and former fiscal year, if changed since last report)

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 ☐ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "accelerated filer," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act

Large accelerated filer ☐

Accelerated filer ☐

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Non-accelerated filer ☐ (Do not check if a smaller reporting company) ☐ Smaller Reporting Company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
☐ Yes ☒ No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

| Class | Number of Shares Outstanding at October 17, 2008 |
|--------------------------------|-----------------------------------------------------|
| Common Stock, \$0.01 par value | 28,191,246 |

MID-AMERICA APARTMENT COMMUNITIES, INC.

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Item 1. Financial Statements.

Mid-America Apartment Communities, Inc.
Condensed Consolidated Balance Sheets
September 30, 2008 (Unaudited) and December 31, 2007
(Dollars in thousands, except per share data)

| | September 30, 2008 | December 31, 2007 |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------|-------------------|
| Assets: | | |
| Real estate assets: | | |
| Land | \$ 239,786 | \$ 214,743 |
| Buildings and improvements | 2,167,951 | 2,044,380 |
| Furniture, fixtures and equipment | 62,658 | 55,602 |
| Capital improvements in progress | 35,354 | 12,886 |
| | 2,505,749 | 2,327,611 |
| Less accumulated depreciation | (667,867) | (616,364) |
| | 1,837,882 | 1,711,247 |
| Land held for future development | 1,306 | 2,360 |
| Commercial properties, net | 7,762 | 6,778 |
| Investments in real estate joint ventures | 6,897 | 168 |
| Real estate assets, net | 1,853,847 | 1,720,553 |
| Cash and cash equivalents | 43,669 | 17,192 |
| Restricted cash | 4,274 | 3,724 |
| Deferred financing costs, net | 15,689 | 15,219 |
| Other assets | 24,084 | 23,028 |
| Goodwill | 4,106 | 4,106 |
| Assets held for sale | 29,366 | - |
| Total assets | \$ 1,975,035 | \$ 1,783,822 |
| Liabilities and Shareholders' Equity: | | |
| Liabilities: | | |
| Notes payable | \$ 1,356,200 | \$ 1,264,620 |
| Accounts payable | 2,395 | 1,099 |
| Accrued expenses and other liabilities | 96,731 | 77,252 |
| Security deposits | 8,831 | 8,453 |
| Liabilities associated with assets held for sale | 803 | - |
| Total liabilities | 1,464,960 | 1,351,424 |
| Minority interest | 31,609 | 28,868 |
| Redeemable stock | 2,250 | 2,574 |
| Shareholders' equity: | | |
| Preferred stock, \$0.01 par value per share, 20,000,000 shares authorized, \$155,000 or \$25 per share liquidation preference; 8.30% Series H Cumulative Redeemable Preferred Stock, 6,200,000 | | |

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| | | |
|---------------------------------------------------|--------------|--------------|
| shares authorized, 6,200,000 | | |
| shares issued and outstanding | | |
| Common stock, \$0.01 par value per share, | | |
| 50,000,000 shares authorized; | | |
| 28,089,334 and 25,718,880 shares issued | | |
| and outstanding at | | |
| September 30, 2008, and December 31, | 280 | 257 |
| 2007, respectively (1) | | |
| Additional paid-in capital | 947,923 | 832,511 |
| Accumulated distributions in excess of net income | (452,420) | (414,966) |
| Accumulated other comprehensive income | (19,629) | (16,908) |
| Total shareholders' equity | 476,216 | 400,956 |
| Total liabilities and shareholders' equity | \$ 1,975,035 | \$ 1,783,822 |

- (1) Number of shares issued and outstanding represent total shares of common stock regardless of classification on the consolidated balance sheet. The number of shares classified as redeemable stock on the consolidated balance sheet for September 30, 2008 and December 31, 2007, are 45,784 and 60,212, respectively.

See accompanying notes to condensed consolidated financial statements.

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Mid-America Apartment Communities, Inc.
Condensed Consolidated Statements of Operations
Three and nine months ended September 30, 2008, and 2007 (Unaudited)
(Dollars in thousands, except per share data)

| | Three months ended September 30, | | Nine months ended September 30, | |
|----------------------------------------------------------------------------------------------------------|-------------------------------------|-----------|------------------------------------|------------|
| | 2008 | 2007 | 2008 | 2007 |
| Operating revenues: | | | | |
| Rental revenues | \$ 89,047 | \$ 84,513 | \$ 262,327 | \$ 245,321 |
| Other property revenues | 4,368 | 3,910 | 12,539 | 11,393 |
| Total property revenues | 93,415 | 88,423 | 274,866 | 256,714 |
| Management fee income | 58 | - | 147 | 34 |
| Total operating revenues | 93,473 | 88,423 | 275,013 | 256,748 |
| Property operating expenses: | | | | |
| Personnel | 11,972 | 10,833 | 34,470 | 31,015 |
| Building repairs and maintenance | 4,138 | 3,494 | 10,473 | 9,522 |
| Real estate taxes and insurance | 11,235 | 10,232 | 33,995 | 32,517 |
| Utilities | 6,162 | 5,531 | 16,162 | 14,862 |
| Landscaping | 2,277 | 2,206 | 6,814 | 6,450 |
| Other operating | 5,018 | 4,109 | 13,380 | 11,773 |
| Depreciation | 22,558 | 21,525 | 66,373 | 63,078 |
| Total property operating expenses | 63,360 | 57,930 | 181,667 | 169,217 |
| Property management expenses | 4,230 | 4,357 | 12,875 | 13,150 |
| General and administrative expenses | 2,996 | 2,401 | 8,747 | 7,629 |
| Income from continuing operations before non-operating items | 22,887 | 23,735 | 71,724 | 66,752 |
| Interest and other non-property income | 115 | 4 | 339 | 148 |
| Interest expense | (15,004) | (15,887) | (46,184) | (47,428) |
| Loss on debt extinguishment | (3) | (71) | (3) | (123) |
| Amortization of deferred financing costs | (586) | (614) | (1,700) | (1,749) |
| Incentive fees from real estate joint ventures | - | - | - | 1,019 |
| Net casualty (loss) gains and other settlement proceeds | (1,131) | (197) | (587) | 645 |
| Gain (loss) on sale of non-depreciable assets | - | 29 | (3) | 255 |
| Income from continuing operations before minority interest and investments in real estate joint ventures | 6,278 | 6,999 | 23,586 | 19,519 |
| Minority interest in operating partnership income | (321) | (1,034) | (1,366) | (2,835) |
| (Loss) income from real estate joint ventures | (274) | 1 | (556) | 5,330 |
| Income from continuing operations | 5,683 | 5,966 | 21,664 | 22,014 |
| Discontinued operations: | | | | |
| Income from discontinued operations before gain (loss) on sale | 510 | 220 | 972 | 1,171 |
| Gains (loss) on sale of discontinued operations | - | 5,714 | (120) | 9,157 |
| Net income | 6,193 | 11,900 | 22,516 | 32,342 |

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| | | | | |
|---------------------------------------------------------------------|----------|----------|-----------|-----------|
| Preferred dividend distributions | 3,216 | 3,491 | 9,649 | 10,472 |
| Net income available for common shareholders | \$ 2,977 | \$ 8,409 | \$ 12,867 | \$ 21,870 |
| Weighted average shares outstanding (in thousands): | | | | |
| Basic | 27,474 | 25,362 | 26,570 | 25,247 |
| Effect of dilutive stock options | 88 | 152 | 115 | 176 |
| Diluted | 27,562 | 25,514 | 26,685 | 25,423 |
| Net income available for common shareholders | \$ 2,977 | \$ 8,409 | \$ 12,867 | \$ 21,870 |
| Discontinued property operations | (510) | (5,934) | (852) | (10,328) |
| Income from continuing operations available for common shareholders | \$ 2,467 | \$ 2,475 | \$ 12,015 | \$ 11,542 |
| Earnings per share - basic: | | | | |
| Income from continuing operations available for common shareholders | \$ 0.09 | \$ 0.10 | \$ 0.45 | \$ 0.46 |
| Discontinued property operations | 0.02 | 0.23 | 0.03 | 0.41 |
| Net income available for common shareholders | \$ 0.11 | \$ 0.33 | \$ 0.48 | \$ 0.87 |
| Earnings per share - diluted: | | | | |
| Income from continuing operations available for common shareholders | \$ 0.09 | \$ 0.10 | \$ 0.45 | \$ 0.45 |
| Discontinued property operations | 0.02 | 0.23 | 0.03 | 0.41 |
| Net income available for common shareholders | \$ 0.11 | \$ 0.33 | \$ 0.48 | \$ 0.86 |
| Dividends declared per common share | \$ 0.615 | \$ 0.605 | \$ 1.845 | \$ 1.815 |

See accompanying notes to condensed consolidated financial statements.

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Mid-America Apartment Communities, Inc.
Consolidated Statements of Cash Flows
Nine Months Ended September 30, 2008 and 2007 (Unaudited)
(Dollars in thousands)

| | 2008 | 2007 |
|-----------------------------------------------------------------------------------|-----------|-----------|
| Cash flows from operating activities: | | |
| Net income | \$ 22,516 | \$ 32,342 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Income from discontinued operations before gain (loss) on sale | (972) | (1,171) |
| Depreciation and amortization of deferred financing costs | 68,073 | 64,827 |
| Stock compensation expense | 704 | 558 |
| Stock issued to employee stock ownership plan | 743 | 658 |
| Redeemable stock issued | 323 | 348 |
| Amortization of debt premium | (1,320) | (1,528) |
| Loss from investments in real estate joint ventures | 594 | 58 |
| Minority interest in operating partnership income | 1,366 | 2,835 |
| Loss on debt extinguishment | 3 | 123 |
| Derivative interest expense (income) | 189 | (234) |
| Loss (gain) on sale of non-depreciable assets | 3 | (255) |
| Loss (gain) on sale of discontinued operations | 120 | (9,157) |
| Gains on disposition within real estate joint ventures | (38) | (5,388) |
| Incentive fees from real estate joint ventures | - | (1,019) |
| Net casualty loss (gains) and other settlement proceeds | 587 | (645) |
| Changes in assets and liabilities: | | |
| Restricted cash | (614) | (950) |
| Other assets | 2,070 | 776 |
| Accounts payable | 1,381 | (842) |
| Accrued expenses and other | 9,196 | 7,020 |
| Security deposits | 610 | 778 |
| Net cash provided by operating activities | 105,534 | 89,134 |
| Cash flows from investing activities: | | |
| Purchases of real estate and other assets | (156,088) | (88,601) |
| Improvements to existing real estate assets | (28,512) | (22,051) |
| Renovations to existing real estate assets | (14,402) | (7,897) |
| Development | (19,075) | (11,771) |
| Distributions from real estate joint ventures | 1 | 9,855 |
| Contributions to real estate joint ventures | (7,352) | (126) |
| Proceeds from disposition of real estate assets | 1,371 | 28,429 |
| Net cash used in investing activities | (224,057) | (92,162) |
| Cash flows from financing activities: | | |
| Net change in credit lines | 177,150 | 52,888 |
| Principal payments on notes payable | (84,250) | (12,027) |
| Payment of deferred financing costs | (2,182) | (1,468) |
| Repurchase of common stock | (644) | (123) |

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| | | |
|------------------------------------------------------------------------|------------|------------|
| Proceeds from issuances of common shares and units | 117,885 | 23,235 |
| Distributions to unitholders | (4,740) | (4,612) |
| Dividends paid on common shares | (48,570) | (45,897) |
| Dividends paid on preferred shares | (9,649) | (10,472) |
| Net cash provided by financing activities | 145,000 | 1,524 |
| Net increase (decrease) in cash and cash equivalents | 26,477 | (1,504) |
| Cash and cash equivalents, beginning of period | 17,192 | 5,545 |
| Cash and cash equivalents, end of period | \$ 43,669 | \$ 4,041 |
| Supplemental disclosure of cash flow information: | | |
| Interest paid | \$ 47,223 | \$ 50,427 |
| Supplemental disclosure of noncash investing and financing activities: | | |
| Conversion of units to common shares | \$ 199 | \$ 90 |
| Interest capitalized | \$ 596 | \$ 720 |
| Marked-to-market adjustment on derivative instruments | \$ (2,818) | \$ (9,221) |
| Reclass of redeemable stock from equity to liabilities | \$ 477 | \$ 445 |

See accompanying notes to condensed consolidated financial statements.

Mid-America Apartment Communities, Inc.
Notes to Condensed Consolidated Financial Statements
September 30, 2008, and 2007 (Unaudited)

1. Consolidation and Basis of Presentation

Mid-America Apartment Communities, Inc. is a self-administered real estate investment trust, or REIT, that owns, acquires, renovates, develops and manages apartment communities in the Sunbelt region of the United States. As of September 30, 2008, we owned or owned interests in 145 multifamily apartment communities comprising 42,427 apartments located in 13 states, including 2 communities comprising 626 apartments owned through our joint venture, Mid-America Multifamily Fund I, LLC, or Fund I, and 2 development communities in varying stages of lease-up. Four of these communities, consisting of 990 apartments, were classified as held for sale as of September 30, 2008. In addition, we had 124 apartments under development and not yet in lease-up adjacent to one of our existing communities.

The accompanying unaudited condensed consolidated financial statements have been prepared by our management in accordance with U.S. generally accepted accounting principles for interim financial information and applicable rules and regulations of the Securities and Exchange Commission and our accounting policies in effect as of December 31, 2007 as set forth in our annual consolidated financial statements, as of such date. The accompanying unaudited condensed consolidated financial statements include the accounts of Mid-America Apartment Communities, Inc. and its subsidiaries, including Mid-America Apartments, L.P. In our opinion, all adjustments necessary for a fair presentation of the condensed consolidated financial statements have been included and all such adjustments were of a normal recurring nature. All significant intercompany accounts and transactions have been eliminated in consolidation. The results of operations for the three and nine month periods ended September 30, 2008 are not necessarily indicative of the results to be expected for the full year. These financial statements should be read in conjunction with our audited financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2007.

The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent liabilities at the dates of the financial statements and the amounts of revenues and expenses during the reporting periods. Actual amounts realized or paid could differ from those estimates.

2. Segment Information

As of September 30, 2008, we owned or had an ownership interest in 145 multifamily apartment communities in 13 different states from which we derived all significant sources of earnings and operating cash flows. Our operational structure is organized on a decentralized basis, with individual property managers having overall responsibility and authority regarding the operations of their respective properties. Each property manager individually monitors local, market and submarket trends in rental rates, occupancy percentages, and operating costs. Property managers are given the on-site responsibility and discretion to react to such trends in our best interest. Our chief operating decision maker evaluates the performance of each individual property based on its contribution to net operating income in order to ensure that the individual property continues to meet our return criteria and long-term investment goals. We define each of our multifamily communities as an individual operating segment. We have also determined that all of our communities have similar economic characteristics and also meet the other criteria which permit the communities to be aggregated into one reportable segment, which is the acquisition and operation of the multifamily communities owned.

3. Comprehensive Income

Total comprehensive income and its components for the three and nine month periods ended September 30, 2008, and 2007 were as follows (dollars in thousands):

| | Three months ended September 30, | | Nine months ended September 30, | |
|----------------------------------------------------------|-------------------------------------|------------|------------------------------------|-----------|
| | 2008 | 2007 | 2008 | 2007 |
| Net income | \$ 6,193 | \$ 11,900 | \$ 22,516 | \$ 32,342 |
| Marked-to-market adjustment on derivative instruments | (4,697) | (16,166) | (2,721) | (9,221) |
| Total comprehensive income (loss) | \$ 1,496 | \$ (4,266) | \$ 19,795 | \$ 23,121 |

The marked-to-market adjustment on derivative instruments is based upon the change of interest rates available for derivative instruments with similar terms and remaining maturities existing at each balance sheet date.

4. Real Estate Acquisitions

On September 14, 2007, we entered into an option contract to purchase the Cascade at Fall Creek apartments, a 246-unit community being built next to our Chalet at Fall Creek apartments in Humble, Texas, a suburb of Houston. Among other provisions, the contract required certain construction completion levels for purchase. On January 10, 2008, the provisions of the contract were met and we acquired the Cascade at Fall Creek apartment community.

On January 17, 2008, Fund I, our joint venture with institutional capital, acquired the Milstead Village apartments, a 310-unit community located in Kennesaw, Georgia, a suburb of Atlanta. This was the first acquisition made by Fund I.

On March 27, 2008, Fund I acquired a second property, the Greenwood Forest apartments, a 316-unit community located in Greenwood Forest, Texas, a suburb of Houston. Fund I does not expect to acquire any additional apartment communities.

On May 21, 2008, we purchased the Providence at Brier Creek apartments, a 313-unit community located in Raleigh, North Carolina.

On July 31, 2008, we purchased the Edge at Lyon's Gate apartments, a 312-unit community located in Gilbert, Arizona, a suburb of Phoenix.

On August 13, 2008, we purchased the Sanctuary at Oglethorpe apartments, a 250-unit community located in Atlanta, Georgia.

On August 27, 2008, we purchased 215 units of the 234-unit Village Oaks apartments located in Temple Terrace, Florida, a suburb of Tampa. On August 29, 2008, we purchased one of the 19 units which had been sold as condominiums and it is our intent to attempt to acquire the remaining 18 units and operate them as apartment rentals with the rest of the community.

5. Discontinued Operations

As part of our portfolio strategy to selectively dispose of mature assets that no longer meet our investment criteria and long-term strategic objectives, in April 2006, we entered into an agreement to list the 184-unit Gleneagles apartments and the 200-unit Hickory Farm apartments both located in Memphis, Tennessee, for sale. Both of these communities

were subsequently sold on May 3, 2007. Also in line with this strategy, in March 2007, we entered into an agreement to list the 144-unit Somerset apartments and the 192-unit Woodridge apartments both located in Jackson, Mississippi, for sale. Both of these communities were subsequently sold on July 16, 2007. In July 2008, we entered into marketing contracts to list the 440-unit River Trace apartments in Memphis, Tennessee, the 96-unit Riverhills apartments in Grenada, Mississippi, the 150-unit Westbury Springs apartments in Lilburn, Georgia, and the 304-unit Woodstream apartments in Greensboro, North Carolina. In accordance with Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, or Statement 144, all of these communities are considered discontinued operations in the accompanying condensed consolidated financial statements.

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The following is a summary of discontinued operations for the three and nine month periods ended September 30, 2008, and 2007, (dollars in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---------------------------------------------------------|-------------------------------------|----------|------------------------------------|-----------|
| | 2008 | 2007 | 2008 | 2007 |
| Revenues | | | | |
| Rental revenues | \$ 1,653 | \$ 1,756 | \$ 4,910 | \$ 6,997 |
| Other revenues | 95 | 88 | 276 | 367 |
| Total revenues | 1,748 | 1,844 | 5,186 | 7,364 |
| Expenses | | | | |
| Property operating expenses | 1,055 | 913 | 2,859 | 3,697 |
| Depreciation | 5 | 435 | 878 | 1,410 |
| Interest and other non-property income | - | - | - | (1) |
| Interest expense | 178 | 276 | 477 | 1,087 |
| Asset impairment | - | - | - | - |
| Total expense | 1,238 | 1,624 | 4,214 | 6,193 |
| Income from discontinued operations before gain on sale | 510 | 220 | 972 | 1,171 |
| Gain (loss) on sale of discontinued operations | - | 5,714 | (120) (1) | 9,157 |
| Income from discontinued operations | \$ 510 | \$ 5,934 | \$ 852 | \$ 10,328 |

(1) Amount represents adjustment related to final expenses from a disposition of real estate assets in a prior period.

6. Share and Unit Information

On September 30, 2008, 28,089,334 shares of common stock and 2,406,411 operating partnership units were outstanding, representing a total of 30,495,745 shares and units. Additionally, we had outstanding options for the purchase of 26,182 shares of common stock at September 30, 2008, of which 13,525 were anti-dilutive. At September 30, 2007, 25,572,886 shares of common stock and 2,482,110 operating partnership units were outstanding, representing a total of 28,054,996 shares and units. Additionally, we had outstanding options for the purchase of 112,706 shares of common stock at September 30, 2007, of which 53,260 were anti-dilutive.

In the first six months of 2008, we issued a total of 1,482,300 shares of common stock through at-the-market offerings or negotiated transactions for net proceeds of \$79.5 million under an existing controlled equity offering program, which exhausted the authorized shares in the sales agreement.

In July, 2008, we entered into a second controlled equity offering sales agreement with similar terms authorizing the sale of up to 1,350,000 shares of common stock. During the three months ended September 30, 2008, we issued a total of 373,000 shares of common stock through this agreement for net proceeds of \$19.1 million.

For the nine months ended September 30, 2008, we issued a total of 1,855,300 shares of common stock through controlled equity offering programs for total net proceeds of \$98.6 million.

7. Derivative Financial Instruments

In the normal course of business, we use certain derivative financial instruments to manage, or hedge, the interest rate risk associated with our variable rate debt or to hedge anticipated future debt transactions to manage well-defined interest rate risk associated with the transaction.

We do not use derivative financial instruments for speculative or trading purposes. Further, we have a policy of entering into contracts with major financial institutions based upon their credit rating and other factors. When viewed in conjunction with the underlying and offsetting exposure that the derivatives are designated to hedge, we have not sustained any material loss from those instruments nor do we anticipate any material adverse effect on our net income or financial position in the future from the use of derivatives.

We require that derivative financial instruments designated as cash flow hedges be effective in reducing the interest rate risk exposure that they are designated to hedge. This effectiveness is essential for qualifying for hedge accounting. Instruments that meet the hedging criteria are formally designated as hedging instruments at the inception of the derivative contract. We formally document all relationships between hedging instruments and hedged items, as well as our risk-management objective and strategy for undertaking the hedge transaction. This process includes linking all derivatives that are designated as fair value or cash flow hedges to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. We also formally assess, both at the inception of the hedging relationship and on an ongoing basis, whether the derivatives used are highly effective in offsetting changes in cash flows of hedged items. When it is determined that a derivative has ceased to be a highly effective hedge, we discontinue hedge accounting prospectively.

All of our derivative financial instruments are reported at fair value, are represented on the balance sheet, and are characterized as cash flow hedges. These transactions hedge the future cash flows of debt transactions through interest rate swaps that convert variable payments to fixed payments and interest rate caps that limit the exposure to rising interest rates. The unrealized gains/losses in the fair value of these hedging instruments are reported on the balance sheet with a corresponding adjustment to accumulated other comprehensive income, with any ineffective portion of the hedging transactions reclassified to earnings. As of September 30, 2008, and 2007, the year-to-date ineffective portion of the hedging transactions reclassified to earnings was a \$97,000 increase, and a \$283,000 decrease, respectively, to interest expense.

On January 1, 2008, we adopted Statement of Financial Accounting Standards No. 157, Fair Value Measurements, or Statement 157. Statement 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. Statement 157 applies to reported balances that are required or permitted to be measured at fair value under existing accounting pronouncements; accordingly, the standard does not require any new fair value measurements of reported balances.

Statement 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, Statement 157 establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that we have the ability to access. Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable for the

asset or liability, either directly or indirectly. Level 2 inputs may include quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the asset or liability (other than quoted prices), such as interest rates, foreign exchange rates, and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability, which are typically based on an entity's own assumptions, as there is little, if any, related market activity. In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

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Currently, we use certain derivative financial instruments to manage our interest rate risk. The valuation of these instruments is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. The fair values of interest rate swaps are determined using the market standard methodology of netting the discounted future fixed cash payments and the discounted expected variable cash receipts. The variable cash receipts are based on an expectation of future interest rates (forward curves) derived from observable market interest rate curves.

The fair values of interest rate options are determined using the market standard methodology of discounting the future expected cash receipts that would occur if variable interest rates rise above the strike rate of the caps. The variable interest rates used in the calculation of projected receipts on the cap are based on an expectation of future interest rates derived from observable market interest rate curves and volatilities. To comply with the provisions of Statement 157, we incorporate credit valuation adjustments to appropriately reflect both our own nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements of all our derivative financial instruments. In adjusting the fair value of our derivative contracts for the effect of nonperformance risk, we have considered the impact of netting and any applicable credit enhancements, such as collateral postings, thresholds, mutual puts, and guarantees.

Although we have determined that the majority of the inputs used to value our derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with our derivatives utilize Level 3 inputs, such as estimates of current credit spreads, to evaluate the likelihood of default by us and our counterparties. As of September 30, 2008, we have assessed the significance of the impact of the credit valuation adjustments on the overall valuation of our derivative positions and have determined that the credit valuation adjustments are significant to the overall valuation of our derivatives. As a result, we have determined that our derivative valuations in their entirety are classified in Level 3 of the fair value hierarchy.

The table below presents our assets and liabilities measured at fair value on a recurring basis as of September 30, 2008, aggregated by the level in the fair value hierarchy within which those measurements fall.

Assets and Liabilities Measured at Fair Value on a Recurring Basis at September 30, 2008
(dollars in thousands)

| | | Quoted Prices in Active Markets for Identical Assets and Liabilities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance at September 30, 2008 |
|-------------|-------------------------------------|--------------------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|----------------------------------------|
| Assets | | | | | |
| | Derivative financial instruments | \$ - | \$ - | \$ 977 | \$ 977 |
| Liabilities | | | | | |
| | Derivative financial instruments | \$ - | \$ - | \$ 19,957 | \$ 19,957 |

The table below presents a reconciliation of the beginning and ending balances of assets and liabilities having fair value measurements based on significant unobservable inputs (Level 3).

Changes in Level 3 Assets/(Liabilities) Measured at Fair Value on a Recurring Basis
for the Nine Months Ended September 30, 2008
(dollars in thousands)

| | Balance at 12/31/2007 | Total Gains Included in Income | Total Realized and Unrealized Gains Included in Other Comprehensive Income | Purchases, Issuances and Settlements | Net Transfers In and/or Out of Level 3 | Balance at 9/30/2008 |
|----------------------------------------|--------------------------|--------------------------------------|----------------------------------------------------------------------------------------|--------------------------------------------|----------------------------------------------|-------------------------|
| Derivative financial instruments | \$ (15,976) | \$ (223) | \$ (2,816) | \$ 35 | \$ - | \$ (18,980) |

Changes in Level 3 Assets/(Liabilities) Measured at Fair Value on a Recurring Basis
for the Period July 1, 2008 to September 30, 2008
(dollars in thousands)

| | Balance at 6/30/2008 | Total Gains Included in Income | Total Realized and Unrealized Gains Included in Other Comprehensive Income | Purchases, Issuances and Settlements | Net Transfers In and/or Out of Level 3 | Balance at 9/30/2008 |
|----------------------------------------|-------------------------|--------------------------------------|----------------------------------------------------------------------------------------|--------------------------------------------|----------------------------------------------|-------------------------|
| Derivative financial instruments | \$ (14,367) | \$ 84 | \$ (4,697) | \$ - | \$ - | \$ (18,980) |

Of the instruments for which we utilized significant Level 3 inputs to determine fair value and that were still held by us at September 30, 2008, the unrealized loss for the nine months ended September 30, 2008 was \$3,020,000. The fair value of these instruments are reported on the balance sheet in Other Assets and Accrued Expenses and Other Liabilities with a corresponding adjustment for the unrealized gains/losses to accumulated other comprehensive income, with any ineffective portion of the hedging transactions reclassified to interest expense.

Both observable and unobservable inputs may be used to determine the fair value of positions that we have classified within the Level 3 category. As a result, the unrealized gains and losses for assets and liabilities within the Level 3 category presented in the tables above may include changes in fair value that were attributable to both observable and unobservable inputs.

8. Recent Accounting Pronouncements

In September 2006, the FASB issued Statement 157. Statement 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. Statement 157 is effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. FASB Staff Position No. FAS 157-2 Effective Date of FASB Statement 157, or FSP 157-2, delays the effective date of Statement 157 for

nonfinancial assets and nonfinancial liabilities except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. For these items, the effective date will be for fiscal years beginning after November 15, 2008. We adopted Statement 157 effective January 1, 2008. Management does not believe the adoption has had or will have a material impact on our consolidated financial condition or results of operations taken as a whole.

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On December 4, 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (Revised 2007), Business Combinations, or Statement 141R. Statement 141R will significantly change the accounting for business combinations. Under Statement 141R, an acquiring entity will be required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. Statement 141R will change the accounting treatment for certain specific items, including acquisition costs which will generally be expensed as incurred. This will have a material impact on the way we account for property acquisitions and therefore will have a material impact on our financial statements. Statement 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008.

On December 4, 2007, the FASB issued Statement of Financial Accounting Standards No. 160, Noncontrolling Interests in Consolidated Financial Statements - An Amendment of ARB No. 51, or Statement 160. Statement 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, this statement requires the recognition of a noncontrolling interest (minority interest) as equity in the consolidated financial statements and separate from the parent's equity. The amount of net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement. Statement 160 clarifies that changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. This will impact our financial statement presentation by requiring the minority interests in the operating partnership to be presented as a non-controlling interest as a component of equity. Statement 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008.

On March 19, 2008, the FASB issued FASB Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities - an Amendment of FASB Statement 133, or Statement 161. Statement 161 enhances required disclosures regarding derivatives and hedging activities, including enhanced disclosures regarding how an entity uses derivative instruments and how derivative instruments and related hedged items are accounted for under FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, and how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. Statement 161 is effective for fiscal years and interim periods beginning after November 15, 2008.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion should be read in conjunction with the condensed consolidated financial statements and notes appearing elsewhere in this report. Historical results and trends which might appear in the condensed consolidated financial statements should not be interpreted as being indicative of future operations.

Forward Looking Statements

We consider portions of this Report to be forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, with respect to our expectations for future periods. Forward looking statements do not discuss historical fact, but instead include statements related to expectations, projections, intentions or other items related to the future. Such forward-looking statements include, without limitation, statements concerning property acquisitions and dispositions, development activity and capital expenditures, capital raising activities, rent growth, occupancy, and rental expense growth. Words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates," and variations of such words and similar expressions are intended to identify such forward-looking statements. Such statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements to be materially different from the results of operations or plans expressed or implied by such forward-looking statements. Such factors include, among other things, unanticipated adverse business developments affecting us, or our properties, adverse changes in the real estate markets and general and local economies and business conditions. Although we believe that the assumptions underlying the forward-looking statements contained herein are reasonable, any of the

assumptions could be inaccurate, and therefore such forward-looking statements included in this report may not prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by us or any other person that the results or conditions described in such statements or our objectives and plans will be achieved.

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The following factors, among others, could cause our future results to differ materially from those expressed in the forward-looking statements:

- inability to generate sufficient cash flows due to market conditions, changes in supply and/or demand, competition, uninsured losses, changes in tax and housing laws, or other factors;
 - inability to acquire funding through the capital markets;
- inability to pay required distributions to maintain REIT status due to required debt payments;
 - changes in variable interest rates;
- loss of hedge accounting treatment for interest rate swaps due to volatility in the financial markets;
 - unexpected capital needs;
- significant disruption in the credit markets, including the inability of Fannie Mae and Freddie Mac to continue as major suppliers of debt financing for multi-family housing and for us;
 - increasing real estate taxes and insurance costs;
- losses from catastrophes in excess of our insurance coverage;
 - inability to meet loan covenants;
 - inability to attract and retain qualified personnel,
- failure of new acquisitions to achieve anticipated results or be efficiently integrated into us;
 - inability to timely dispose of assets;
 - potential liability for environmental contamination;
- litigation and compliance costs associated with laws requiring access for disabled persons;
 - inability of a joint venture to perform as expected; and
- the imposition of federal taxes if we fail to qualify as a REIT under the Internal Revenue Code in any taxable year or foregone opportunities to ensure REIT status.

These factors, among others, are set forth below in Part II, Item 1A. Risk Factors. We encourage investors to review these risks factors.

Critical Accounting Policies and Estimates

The following discussion and analysis of financial condition and results of operations are based upon our condensed consolidated financial statements, and the notes thereto, which have been prepared in accordance with U.S. generally accepted accounting principles, or GAAP. The preparation of these condensed consolidated financial statements requires us to make a number of estimates and assumptions that affect the reported amounts and disclosures in the condensed consolidated financial statements. On an ongoing basis, we evaluate our estimates and assumptions based upon historical experience and various other factors and circumstances. We believe that our estimates and assumptions are reasonable under the circumstances; however, actual results may differ from these estimates and assumptions.

We believe that the estimates and assumptions listed below are most important to the portrayal of our financial condition and results of operations because they require the greatest subjective determinations and form the basis of accounting policies deemed to be most critical. These critical accounting policies include revenue recognition, capitalization of expenditures and depreciation of assets, impairment of long-lived assets, including goodwill, and fair value of derivative financial instruments.

Revenue Recognition

We lease multifamily residential apartments under operating leases primarily with terms of one year or less. Rental revenues are recognized using a method that represents a straight-line basis over the term of the lease and other revenues are recorded when earned.

We record all gains and losses on sales of real estate in accordance with Statement No. 66, Accounting for Sales of Real Estate.

Capitalization of expenditures and depreciation of assets

We carry real estate assets at depreciated cost. Depreciation is computed on a straight-line basis over the estimated useful lives of the related assets, which range from 8 to 40 years for land improvements and buildings, 5 years for furniture, fixtures, and equipment, 3 to 5 years for computers and software, and 1 year for acquired leases, all of which are subjective determinations. Repairs and maintenance costs are expensed as incurred while significant improvements, renovations, and replacements are capitalized. The cost to complete any deferred repairs and maintenance at properties acquired by us in order to elevate the condition of the property to our standards are capitalized as incurred.

Development costs, which are limited to adding new units to three existing properties, are capitalized in accordance with Statement of Financial Accounting Standards No. 67, Accounting for Costs and Initial Rental Operations of Real Estate Projects and Statement of Financial Accounting Standards No. 34, Capitalization of Interest Cost.

Impairment of long-lived assets, including goodwill

We account for long-lived assets in accordance with the provisions of Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, or Statement 144, and evaluate our goodwill for impairment under Statement No. 142, Goodwill and Other Intangible Assets, or Statement 142. We evaluate goodwill for impairment on an annual basis in our fiscal fourth quarter, or sooner if a goodwill impairment indicator is identified. We periodically evaluate long-lived assets, including investments in real estate and goodwill, for indicators that would suggest that the carrying amount of the assets may not be recoverable. The judgments regarding the existence of such indicators are based on factors such as operating performance, market conditions, and legal factors.

In accordance with Statement 144, long-lived assets, such as real estate assets, equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of are separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposed group classified as held for sale are presented separately in the appropriate asset and liability sections of the balance sheet.

In accordance with Statement 142, goodwill is tested annually for impairment, and is tested for impairment more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. This determination is made at the reporting unit level and consists of two steps. First, we determine the fair value of a reporting unit and compare the fair value to its carrying amount. In the apartment industry, the primary method used for determining fair value is to divide annual operating cash flows by an appropriate capitalization rate. We determine the appropriate capitalization rate by reviewing the prevailing rates in a property's market or submarket. Second, if the carrying amount of a reporting unit

exceeds its fair value, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation, in accordance with Statement of Financial Accounting Standards No. 141, Business Combinations. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill.

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Fair value of derivative financial instruments

We utilize certain derivative financial instruments, primarily interest rate swaps and caps, during the normal course of business to manage, or hedge, the interest rate risk associated with our variable rate debt or as hedges in anticipation of future debt transactions to manage well-defined interest rate risk associated with the transaction.

In order for a derivative contract to be designated as a hedging instrument, the relationship between the hedging instrument and the hedged item must be highly effective. While our calculation of hedge effectiveness contains some subjective determinations, the historical correlation of the hedging instruments and the underlying hedged item are measured by us before entering into the hedging relationship and have been found to be highly correlated.

We measure ineffectiveness using the change in the variable cash flows method for interest rate swaps and the hypothetical derivative method for interest rate caps for each reporting period through the term of the hedging instruments. Any amounts determined to be ineffective are recorded in earnings. The change in fair value of the interest rate swaps and the intrinsic value of caps designated as cash flow hedges are recorded to accumulated other comprehensive income in the statement of shareholders' equity.

On January 1, 2008, We adopted Statement of Financial Accounting Standards No. 157, Fair Value Measurements, or Statement 157. Statement 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. Statement 157 applies to reported balances that are required or permitted to be measured at fair value under existing accounting pronouncements; accordingly, the standard does not require any new fair value measurements of reported balances.

Statement 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, Statement 157 establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that we have the ability to access. Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs may include quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the asset or liability (other than quoted prices), such as interest rates, foreign exchange rates, and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the asset or liability which are typically based on an entity's own assumptions, as there is little, if any, related market activity. In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

The valuation of our derivative financial instruments is determined using widely accepted valuation techniques including discounted cash flow analysis on the expected cash flows of each derivative. The fair values of interest rate swaps are determined using the market standard methodology of netting the discounted future fixed cash payments and the discounted expected variable cash receipts. The variable cash receipts are based on an expectation of future interest rates (forward curves) derived from observable market interest rate curves. The fair values of interest rate caps are determined using the market standard methodology of discounting the future expected cash receipts that would occur if variable interest rates rise above the strike rate of the caps. The variable interest rates used in the

calculation of projected receipts on the cap are based on an expectation of future interest rates derived from observable market interest rate curves and volatilities. To comply with the provisions of Statement 157, we incorporate credit valuation adjustments to appropriately reflect both our own nonperformance risk and the respective counterparty's nonperformance risk in the fair value measurements. In adjusting the fair value of our derivative contracts for the effect of nonperformance risk, we have considered the impact of netting and any applicable credit enhancements, such as collateral postings, thresholds, mutual puts, and guarantees.

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Although we have determined that the majority of the inputs used to value our derivatives fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with our derivatives utilize Level 3 inputs, such as estimates of current credit spreads, to evaluate the likelihood of default by us and our counterparties. As of September 30, 2008, we have assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its derivative positions and have determined that the credit valuation adjustments are significant to the overall valuation of our derivatives. As a result, we have determined that our derivative valuations in their entirety are classified in Level 3 of the fair value hierarchy. As of September 30, 2008, we had a total of \$976.2 million in derivative instruments, all of which had fair values measured using Level 3 inputs. Realized and unrealized losses did not materially affect our results of operations, liquidity or capital resources during the third quarter. We experienced an overall decrease in fair value of our derivatives due to the fluctuations in the interest rate market throughout the third quarter. We do not anticipate realizing a significant portion of the current unrealized loss.

Overview of the Three Months Ended September 30, 2008

Our operating results for the three months ended September 30, 2008 benefited from increases in property revenues both as a result of the acquisition of seven new communities since June of 2007 and increases in effective rents across existing communities. These increases were somewhat offset by \$0.4 million of expense related to Hurricane Ike damage at 15 communities as well as increases in personnel costs as reduced employee turnover caused less vacant positions.

We benefited from reduced interest expense as the reduction in our average cost of debt more than offset the increase in our debt outstanding.

The following is a discussion of our consolidated financial condition and results of operations for the three and nine month periods ended September 30, 2008. This discussion should be read in conjunction with the condensed consolidated financial statements appearing elsewhere in this Report. These financial statements include all adjustments, which are, in the opinion of management, necessary to reflect a fair statement of the results for the interim period presented, and all such adjustments are of a normal recurring nature.

Results of Operations

Comparison of the Three Months Ended September 30, 2008 to the Three Months Ended September 30, 2007

Property revenues for the three months ended September 30, 2008 were approximately \$93.4 million, an increase of approximately \$5.0 million from the three months ended September 30, 2007 due to (i) a \$3.2 million increase in property revenues from the seven properties acquired since June 2007, or the seven acquisitions, (ii) a \$0.4 million increase in property revenues from our development communities, and (iii) a \$1.4 million increase in property revenues from all other communities. The increase in property revenues from all other communities was generated primarily by our same store portfolio and was driven by a 1.6% increase in average effective rent per unit in the third quarter of 2008 from the third quarter of 2007. Communities are moved into our same store portfolio the quarter after they have been held and were stabilized for at least 12 months. Communities excluded from the same store portfolio would include recent acquisitions, communities being developed or in lease-up, communities undergoing extensive renovations, and communities identified as discontinued operations.

Property operating expenses include costs for property personnel, property bonuses, building repairs and maintenance, real estate taxes and insurance, utilities, landscaping, other property related costs and depreciation. Property operating expenses, excluding depreciation, for the three months ended September 30, 2008 were approximately \$40.8 million, an increase of approximately \$4.4 million from the three months ended September 30, 2007 due primarily to increases in property operating expenses of (i) \$1.4 million from the seven acquisitions, (ii) \$0.2 million from our development communities, and (iii) \$2.8 million from all other communities. The increase in property operating expenses from all

other communities was generated primarily by our same store portfolio and was driven by \$0.3 million of expense related to Hurricane Ike, a 6.6% increase in personnel expense due to decreased employee turnover rates resulting in fewer vacant positions, an increase in repair and maintenance expense as we turned a higher percentage of vacant units in preparation for the fourth quarter, and a favorable adjustment to real estate taxes in the third quarter of 2007 to reflect lower expected expense, mainly because of changes to assessed values and tax rates in Florida and Texas.

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Depreciation expense for the three months ended September 30, 2008 was approximately \$22.6 million, an increase of approximately \$1.0 million from the three months ended September 30, 2007 primarily due to the increases in depreciation expense of (i) \$1.0 million from the seven acquisitions, and (ii) \$0.7 million from all other communities. Increases of depreciation expense from all other communities resulted from asset additions made during the normal course of business. These increases were partially offset by a decrease in depreciation expense of \$0.7 million from the expiration of the amortization of fair market value of leases of communities which we previously acquired.

Property management expenses for the three months ended September 30, 2008 decreased slightly by approximately \$0.1 million from the third quarter of 2007. General and administrative expenses increased by approximately \$0.6 million over this same period mainly as a result of increased headcount.

Interest expense for the three months ended September 30, 2008 was approximately \$15.0 million, a decrease of \$0.9 million, from the three months ended September 30, 2007 primarily due to a decrease in our average borrowing cost from 5.37% for the third quarter of 2007 to 4.69% for the third quarter of 2008. The decrease in average borrowing cost was partially offset by higher average outstanding balances in the third quarter of 2008 than in the third quarter of 2007.

In the three months ended September 30, 2008, we recorded a net loss of approximately \$1.1 million related to casualty losses. This compares to recorded net losses for the third quarter of 2007 of approximately \$0.2 million.

During the three months ended September 30, 2007, we recorded gains of approximately \$5.7 million related to sales of two of our communities. No communities were sold during the third quarter of 2008.

Primarily as a result of the foregoing, net income decreased by approximately \$5.7 million in the third quarter of 2008 to a total of \$6.2 million from a total of \$11.9 million for the third quarter of 2007.

Comparison of the Nine Months Ended September 30, 2008 to the Nine Months Ended September 30, 2007

Property revenues for the nine months ended September 30, 2008 were approximately \$274.9 million, an increase of approximately \$18.2 million from the nine months ended September 30, 2007 due to (i) an \$9.2 million increase in property revenues from the nine properties acquired since the beginning of 2007, or the nine acquisitions, (ii) an \$1.3 million increase in property revenues from our development communities, and (iii) a \$7.7 million increase in property revenues from all other communities. The increase in property revenues from all other communities was generated primarily by our same store portfolio and was driven by increases in average effective rent per unit and a reduction in the rate of concessions of net potential rent from the first nine months of 2007 to the first nine months of 2008.

Property operating expenses include costs for property personnel, property bonuses, building repairs and maintenance, real estate taxes and insurance, utilities, landscaping, other property related costs and depreciation. Property operating expenses, excluding depreciation, for the nine months ended September 30, 2008 were approximately \$115.3 million, an increase of approximately \$9.2 million from the nine months ended September 30, 2007 due primarily to increases in property operating expenses of (i) \$4.5 million from the nine acquisitions, (ii) \$0.5 million from our development communities, and (iii) \$4.2 million from all other communities. The increase in property operating expenses from all other communities was generated primarily by our same store portfolio and was driven by \$0.3 million of expense related to Hurricane Ike and an increase in personnel expense due to decreased employee turnover rates resulting in fewer vacant positions.

Depreciation expense for the nine months ended September 30, 2008 was approximately \$66.4 million, an increase of approximately \$3.3 million from the nine months ended September 30, 2007 primarily due to the increases in depreciation expense of (i) \$2.7 million from the nine acquisitions, (ii) \$0.2 million from our development communities, and (iii) \$2.1 million from all other communities. Increases of depreciation expense from all other communities resulted from asset additions made during the normal course of business. These increases were partially offset by a decrease in depreciation expense of \$1.7 million from the expiration of the amortization of fair market value of leases of communities which we previously acquired.

Property management expenses for the nine months ended September 30, 2008 were approximately \$12.9 million, a decrease of \$0.3 million from the nine months ended September 30, 2007. General and administrative expenses increased by approximately \$1.1 million over this same period mainly as a result of increased headcount.

Interest expense for the nine months ended September 30, 2008 was approximately \$46.2 million, a decrease of \$1.2 million from the nine months ended September 30, 2007 primarily due to a decrease in our average borrowing cost from 5.47% for the first nine months of 2007 to 4.89% for the first nine months of 2008. The decrease in average borrowing cost was partially offset by higher average outstanding balances for the first nine months of 2008 than the first nine months of 2007.

In the nine months ended September 30, 2007, we benefited from gains totaling approximately \$15.8 million due to the sale of four properties, the sale of some land, and the sale of joint venture assets and a resultant incentive fee. No properties were sold during the first nine months of 2008.

Primarily as a result of the foregoing, net income decreased by approximately \$9.8 million in the first nine months of 2008 from the first nine months of 2007.

Funds From Operations and Net Income

Funds from operations, or FFO, represents net income (computed in accordance with GAAP), excluding extraordinary items, minority interest in operating partnership income, gains or losses on disposition of real estate assets, plus depreciation of real estate, and adjustments for joint ventures to reflect FFO on the same basis. This definition of FFO is in accordance with the National Association of Real Estate Investment Trust's, or NAREIT, definition. Disposition of real estate assets includes sales of discontinued operations as well as proceeds received from insurance and other settlements from property damage.

In response to the Securities and Exchange Commission's Staff Policy Statement relating to Emerging Issues Task Force Topic D-42 concerning the calculation of earnings per share for the redemption of preferred stock, we include the amount charged to retire preferred stock in excess of carrying values in our FFO calculation.

Our policy is to expense the cost of interior painting, vinyl flooring, and blinds as incurred for stabilized properties. During the stabilization period, typically the first 12 months, for acquisition properties, these items are capitalized as part of the total repositioning program of newly acquired properties, and thus are not deducted in calculating FFO.

FFO should not be considered as an alternative to net income or any other GAAP measurement of performance, as an indicator of operating performance, or as an alternative to cash flow from operating, investing, and financing activities as a measure of liquidity. We believe that FFO is helpful to investors in understanding our operating performance in that such calculation excludes depreciation expense on real estate assets. We believe that GAAP historical cost depreciation of real estate assets is generally not correlated with changes in the value of those assets, whose value does not diminish predictably over time, as historical cost depreciation implies. Our calculation of FFO may differ from the methodology for calculating FFO utilized by other REITs and, accordingly, may not be comparable to such other REITs.

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The following table is a reconciliation of FFO to net income for the three and nine month periods ended September 30, 2008, and 2007 (dollars and shares in thousands):

| | Three months ended September 30, | | Nine months ended September 30, | |
|---------------------------------------------------------------------|-------------------------------------|-----------|------------------------------------|----------|
| | 2008 | 2007 | 2008 | 2007 |
| Net income | \$ 6,193 | \$ 11,900 | \$ 22,516 | \$32,342 |
| Depreciation of real estate assets | 22,122 | 21,218 | 65,216 | 62,127 |
| Net casualty loss (gains) and other settlement proceeds | 1,131 | 197 | 587 | (645) |
| Gain on dispositions within real estate joint ventures | - | (1) | (38) | (5,388) |
| Depreciation of real estate assets of discontinued operations | 5 | 435 | 878 | 1,410 |
| (Gains) loss on sale of discontinued operations | - | (5,714) | 120 | (9,157) |
| Depreciation of real estate assets of real estate joint ventures | 281 | - | 651 | 14 |
| Preferred dividend distribution | (3,216) | (3,491) | (9,649) | (10,472) |
| Minority interest in operating partnership income | 321 | 1,034 | 1,366 | 2,835 |
| Funds from operations | \$26,837 | \$25,578 | \$ 81,647 | \$73,066 |
| Weighted average shares and units: | | | | |
| Basic | 29,880 | 27,844 | 28,986 | 27,733 |
| Diluted | 29,968 | 27,996 | 29,101 | 27,909 |

FFO for the three and nine month periods ended September 30, 2008 increased primarily as the result of new property acquisitions and a decrease in interest expense from the reduction in our cost of borrowing.

Trends

During the first half of 2008, rental demand for apartments continued at robust levels in most of our markets with the notable exception of Florida, where after several years of good growth, markets were a little weak. Towards the end of the second quarter, we experienced a reduction in our rate of revenue growth, which we think is likely to be due to the slowdown in general economic conditions. During the third quarter of 2008, the rate of revenue growth continued to slow.

Job formation, which is a primary driver of demand by apartment residents, continued in most of our markets, but showed signs of slowing towards the end of the second quarter and through the third quarter of 2008. On the supply side, new apartment construction continued to be limited, as in most markets, rents have yet to rise sufficiently to offset the rapid run-up of costs of new construction over the last five years and financing for new development has become difficult to obtain. Competition from condominiums reverting back to being rental units, or new condominiums being converted to rental, was not a major factor in most of our markets because most of our markets and submarkets have not been primary areas for condominium development. We have found the same to be true for rental competition from single family homes. We have avoided committing a significant amount of capital to markets where most of the excessive inflation in house prices has occurred. We are seeing significant rental competition from condominiums and single family houses in only a few submarkets.

The primary reason that our residents leave us is to buy a house, but we have seen that reason as a percent of total move-outs drop over the past twelve months. Analysts point out that homeownership increased from 65% to over 69% of households over ten years ending in 2005. This increase, representing approximately five million households, was

driven primarily by the availability of new mortgage products, many requiring no down-payment and minimal credit ratings. With a reversion of mortgage underwriting back to more traditional standards, it is possible that a long-term correction will occur, and that home ownership may return to more sustainable levels. This could be quite significant for the apartment business, and we believe, if this occurs, it could benefit us for several years.

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Based on third party research, we believe that the signs of slower revenue growth will be temporary, and that revenue growth should accelerate later in 2009 and 2010. We also believe reduced availability of financing for new apartment construction will likely limit new apartment supply, and more sustainable credit terms for residential mortgages should work to favor rental demand at existing multi-family properties. At the same time, we expect long term demographic trends, including the growth of prime age groups for rentals, immigration, and population movement to the southeast and southwest will continue to build apartment rental demand for our markets.

While it seems possible that we will face slower economic growth as a result of reduced liquidity in the economy, we think that the supply of new apartments is not excessive, and that positive absorption of apartments will occur for most of our markets for the next two or three years. Should the economy fall into a deeper recession, the limited new supply of apartments and the more disciplined mortgage financing for single family home buying should lessen the impact.

Liquidity and Capital Resources

Net cash flow provided by operating activities increased by approximately \$16.4 million from \$89.1 million in the first nine months of 2007 to \$105.5 million in the first nine months of 2008 mainly as a result of the increase in the average number of properties in our portfolio from 137 for the first nine months of 2007 to 142 for the first nine months of 2008.

Net cash used in investing activities increased by approximately \$131.9 million during the first nine months of 2008 to \$224.1 million from \$92.2 million in the first nine months of 2007. In the first nine months of 2008, we spent \$67.5 million more on property acquisitions (including joint venture investments) than in the first nine months of 2007. We also spent an additional \$13.0 million over the same time period on improvements and renovations at existing properties as we expanded our interior renovation program and completed the renovation of 3,118 units in the first nine months of 2008 compared to 1,507 units in the first nine months of 2007. During the first nine months of 2007, we received \$28.4 million related to property dispositions (including joint venture dispositions). There were no property sales during the first nine months of 2008.

The first nine months of 2008 provided \$145.0 million from financing activities compared to \$1.5 million in the first nine months of 2007, an increase of \$143.5 million. This change was mainly due to the proceeds from the issuance of shares of common stock through at-the-market offerings or negotiated transactions under a controlled equity offering program, or CEO. During the first nine months of 2008, we issued a total of 1,855,300 shares of common stock for net proceeds of \$98.6 million under the CEO. During the first nine months of 2007, we issued a total of 323,700 shares of common stock and received net proceeds of \$18.8 million under the CEO.

The weighted average interest rate at September 30, 2008 for the \$1.4 billion of debt outstanding was 5.0%, compared to the weighted average interest rate of 5.6% on \$1.2 billion of debt outstanding at September 30, 2007. We utilize both conventional and tax exempt debt to help finance our activities. Borrowings are made through individual property mortgages as well as company-wide secured credit facilities. We utilize fixed rate borrowings, interest rate swaps and interest rate caps to manage our current and future interest rate risk. More details on our borrowings can be found in the schedule presented later in this section.

At September 30, 2008, we had secured credit facility relationships with Prudential Mortgage Capital which are credit enhanced by the Federal National Mortgage Association, or FNMA, Financial Federal which are credit enhanced by Federal Home Loan Mortgage Corporation, or Freddie Mac, and a facility made up by a group of banks led by Regions Bank. Together, these credit facilities provided a total line capacity of \$1.39 billion and collateralized availability to borrow of \$1.35 billion at September 30, 2008. We had total borrowings outstanding under these credit facilities of \$1.25 billion at September 30, 2008.

Approximately 72% of our outstanding obligations at September 30, 2008 were borrowed through facilities with/or credit enhanced by FNMA, also referred to as the FNMA Facilities. The FNMA Facilities have a combined line limit of \$1.0 billion, practically all of which was collateralized and available to borrow at September 30, 2008. We had total borrowings outstanding under the FNMA Facilities of approximately \$975 million at September 30, 2008. Various tranches of the FNMA Facilities mature from 2011 through 2018. The FNMA Facilities provide for both fixed and variable rate borrowings. The interest rate on the majority of the variable portion is based on the FNMA Discount Mortgage Backed Security, or DMBS, which are credit-enhanced by FNMA and are typically sold every 90 days by Prudential Mortgage Capital at interest rates approximating three-month LIBOR less an average spread of 0.05% - 0.12% over the life of the FNMA Facilities, plus a credit enhancement fee of 0.49% to 0.795%. While, generally, the DMBS continued to trade below three-month LIBOR, the spread between them increased during the fourth quarter of 2007 and the first three quarters of 2008, ranging from 0.05% above three-month LIBOR to 0.73% below three-month LIBOR, with an average for the third quarter of 2008 of 0.05% below three-month LIBOR. While we feel this recent volatility is an anomaly and believe that this spread will return to more historic levels, we cannot forecast when or if the uncertainty and volatility in the market may change.

Approximately 20% of our outstanding obligations at September 30, 2008 were borrowed through facilities with/or credit enhanced by Freddie Mac, also referred to as the Freddie Mac Facilities. The Freddie Mac Facilities have a combined line limit of \$300 million, of which \$276 million was collateralized and available to borrow at September 30, 2008. We had total borrowings outstanding under the Freddie Mac Facilities of approximately \$276 million at September 30, 2008. The Freddie Mac facilities mature in 2011 and 2014. The interest rate on the Freddie Mac Facilities renews every 30 or 90 days and is based on the Freddie Mac Reference Bill Rate on the date of renewal, which has historically approximated LIBOR, plus a credit enhancement fee of 65 basis points to 69 basis points. The Freddie Mac Reference Bill rate has traded consistently below LIBOR, and the historical average spread has risen recently from the more normal 15 basis points to 17 basis points below LIBOR to 32 basis points below LIBOR with a high of 107 basis points below LIBOR on October 1, 2008.

Each of our secured credit facilities is subject to various covenants and conditions on usage, and is subject to periodic re-evaluation of collateral. If we were to fail to satisfy a condition to borrowing, the available credit under one or more of the facilities could not be drawn, which could adversely affect our liquidity. In the event of a reduction in real estate values the amount of available credit could be reduced. Moreover, if we were to fail to make a payment or violate a covenant under a credit facility, after applicable cure periods, one or more of our lenders could declare a default, accelerate the due date for repayment of all amounts outstanding and/or foreclose on properties securing such facilities. Any such event could have a material adverse effect.

As of September 30, 2008, we had entered into interest rate swaps totaling a notional amount of \$793 million. To date, these swaps have proven to be highly effective hedges. We had also entered into an additional \$115 million of forward interest rate swaps as of September 30, 2008, \$65 million of which became effective on October 1, 2008 and \$50 million of which becomes effective on December 1, 2008. As of September 30, 2008, we had entered interest rate cap agreements totaling a notional amount of approximately \$68 million.

We only have two scheduled refinancings prior to 2011. One is a \$39 million mortgage with Regions Bank that matures April 1, 2009. We plan to replace the Regions debt with mortgages from Freddie Mac of which \$23.5 million has already been committed plus, if needed, unused capacity under our existing credit facilities totaling \$136 million and excess cash of \$38 million is available. The other is the \$50 million credit facility with a group of banks led by Regions Bank that matures May 24, 2010.

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Summary details of the debt outstanding at September 30, 2008 follows in the table below (dollars in thousands):

| | Line Limit | Collateralized Line Availability | Outstanding Balance/ Notional Amount | Average Interest Rate | Average Rate Maturity | Average Contract Maturity |
|-----------------|---------------|----------------------------------------|-----------------------------------------------|-----------------------------|-----------------------------|---------------------------------|
| COMBINED | | | | | | |
| DEBT | | | | | | |
| Fixed Rate or | | | | | | |
| Swapped | | | | | | |
| Conventional | | | \$ 880,324 | 5.6% | 9/16/2012 | 11/9/2012 |
| Tax Exempt | | | 37,885 | 4.7% | 4/25/2017 | 4/25/2017 |
| Subtotal | | | 918,209 | 5.5% | 11/26/2012 | 1/16/2013 |
| Fixed Rate | | | | | | |
| or Swapped | | | | | | |
| Variable Rate | | | | | | |
| Conventional | | | 350,945 | 3.5% | 11/29/2008 | 5/24/2014 |
| Tax Exempt | | | 19,040 | 6.3% | 10/11/2008 | 9/22/2017 |
| Conventional | | | 17,936 | 3.4% | 11/13/2009 | 11/13/2009 |
| - Capped | | | | | | |
| Tax Exempt | | | 50,070 | 6.7% | 4/14/2012 | 4/14/2012 |
| - Capped | | | | | | |
| Subtotal | | | 437,991 | 4.0% | 11/23/2008 | 7/3/2014 |
| Variable | | | | | | |
| Rate | | | | | | |
| Total | | | \$ 1,356,200 | 5.0% | 8/11/2011 | 7/7/2013 |
| Combined | | | | | | |
| Debt | | | | | | |
| Outstanding | | | | | | |
| UNDERLYING | | | | | | |
| DEBT | | | | | | |
| Individual | | | | | | |
| Property | | | | | | |
| Mortgages/Bonds | | | | | | |
| Conventional | | | \$ 48,324 | 5.7% | 7/5/2022 | 7/5/2022 |
| Fixed Rate | | | | | | |
| Tax Exempt | | | 11,720 | 5.2% | 12/1/2028 | 12/1/2028 |
| Fixed Rate | | | | | | |
| Tax Exempt | | | 4,760 | 4.9% | 9/30/2008 | 6/1/2028 |
| Variable | | | | | | |
| Rate | | | | | | |
| FNMA Credit | | | | | | |
| Facilities | | | | | | |
| Tax Free | \$ 90,515 | \$ 90,515 | 90,515 | 6.7% | 10/15/2008 | 3/1/2014 |
| Borrowings | | | | | | |
| Conventional | | | | | | |
| Borrowings | | | | | | |
| Fixed Rate | 65,000 | 65,000 | 65,000 | 7.7% | 11/30/2009 | 12/1/2011 |
| Borrowings | | | | | | |

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| | | | | | | |
|--------------------------------|-----------|-----------|---------|------|------------|------------|
| Variable Rate Borrowings | 888,914 | 872,234 | 819,318 | 3.5% | 11/25/2008 | 3/27/2015 |
| Subtotal | 1,044,429 | 1,027,749 | 974,833 | 4.1% | 12/16/2008 | 11/30/2014 |
| FNMA Facilities | | | | | | |
| Freddie Mac Credit Facility I | 100,000 | 96,404 | 96,404 | 3.3% | 12/8/2008 | 7/1/2011 |
| Freddie Mac Credit Facility II | 200,000 | 179,525 | 179,525 | 3.4% | 12/10/2008 | 7/1/2014 |
| Regions Credit Facility | 50,000 | 43,863 | 1,754 | 4.7% | 10/31/2008 | 5/24/2010 |
| Regions Term Loan | | | 38,880 | 3.8% | | |

op:12px;margin-bottom:0px;
text-indent:4%">We and the
Issuer Trusts will make payments
on bearer debt securities only
outside the United States and its
possessions except as permitted by
the above regulations.

Bearer debt securities and any
coupons will bear the following
legend:

Any United States person who
holds this obligation will be subject
to limitations under the United
States income tax laws, including
the limitations provided in
sections 165(j) and 1287(a) of the
Internal Revenue Code.

The sections referred to in this
legend provide that, with
exceptions, a United States person
will not be permitted to deduct any
loss, and will not be eligible for
capital gain treatment with respect
to any gain, realized on the sale,
exchange or redemption of that
bearer debt security or coupon.

As used in this section entitled
Securities Issued in Bearer Form,
United States person means:

a citizen or resident of the
United States for United States
federal income tax purposes;

a corporation or partnership, including an entity treated as a corporation or partnership for United States federal income tax purposes, created or organized in or under the laws of the United States, any state of the United States or the District of Columbia;

an estate the income of which is subject to United States federal income taxation regardless of its source; or

a trust if a court within the United States is able to exercise primary supervision of the administration of the trust and one or more United States persons have the authority to control all substantial decisions of the trust.

In addition, some trusts treated as United States persons before August 20, 1996 may elect to continue to be so treated to the extent provided in the Treasury Regulations.

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**CONSIDERATIONS
RELATING TO INDEXED
SECURITIES**

We use the term "indexed securities" to mean any of the securities described in this prospectus, or any units that include securities, whose value is linked to an underlying property or index. Indexed securities may present a high level of risk, and investors in some indexed securities may lose their entire investment. In addition, the treatment of indexed securities for U.S. federal income tax purposes is often unclear due to the absence of any authority specifically addressing the issues presented by any particular indexed security. Thus, if you propose to invest in indexed securities, you should independently evaluate the federal income tax consequences of purchasing an indexed security that apply in your particular circumstances. You should also read *United States Taxation* for a discussion of U.S. tax matters.

***Investors in Indexed Securities
Could Lose Their Investment***

The amount of principal and/or interest payable on an indexed debt security, the cash value or physical settlement value of a physically settled debt security and the cash value or physical settlement value of an indexed warrant or purchase contract will be determined by reference to the price, value or level of one or more securities, currencies, commodities or other properties, any other financial, economic or other measure or instrument, including the occurrence or non-occurrence of any event or circumstance, and/or one or more indices or baskets of any of these items. We refer to each of these as an "index." The direction and magnitude of the change in the price, value or level of the relevant index will determine the amount of principal and/or interest payable on an indexed debt security, the cash value or physical settlement value

of a physically settled debt security and the cash value or physical settlement value of an indexed warrant or purchase contract. The terms of a particular indexed debt security may or may not include a guaranteed return of a percentage of the face amount at maturity or a minimum interest rate. An indexed warrant or purchase contract generally will not provide for any guaranteed minimum settlement value. Thus, if you purchase an indexed security, you may lose all or a portion of the principal or other amount you invest and may receive no interest on your investment.

The Company That Issues an Index Security or the Government That Issues an Index Currency Could Take Actions That May Adversely Affect an Indexed Security

The issuer of a security that serves as an index or part of an index for an indexed security will have no involvement in the offer and sale of the indexed security and no obligations to the holder of the indexed security. The issuer may take actions, such as a merger or sale of assets, without regard to the interests of the holder. Any of these actions could adversely affect the value of a security indexed to that security or to an index of which that security is a component.

An Indexed Security May Be Linked to a Volatile Index, Which Could Hurt Your Investment

Some indices are highly volatile, which means that their value may change significantly, up or down, over a short period of time. The amount of principal or interest that can be expected to become payable on an indexed debt security or the expected settlement value of an indexed warrant or purchase contract may vary substantially from time to time. Because the amounts payable with respect to an indexed security are generally calculated based on the value or level of the relevant index on a specified date or over a limited period of time, volatility in the

index increases the risk that the return on the indexed security may be adversely affected by a fluctuation in the level of the relevant index.

The volatility of an index may be affected by political or economic events, including governmental actions, or by the activities of participants in the relevant markets.

Any of these events or activities could adversely affect the value of an indexed security.

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***An Index to Which a Security Is
Linked Could Be Changed or
Become Unavailable***

Some indices compiled by us or our affiliates or third parties may consist of or refer to several or many different securities, commodities or currencies or other instruments or measures. The compiler of such an index typically reserves the right to alter the composition of the index and the manner in which the value or level of the index is calculated. An alteration may result in a decrease in the value of or return on an indexed security that is linked to the index. The indices for our indexed securities may include published indices of this kind or customized indices developed by us or our affiliates in connection with particular issues of indexed securities.

A published index may become unavailable, or a customized index may become impossible to calculate in the normal manner, due to events such as war, natural disasters, cessation of publication of the index or a suspension or disruption of trading in one or more securities, commodities or currencies or other instruments or measures on which the index is based. If an index becomes unavailable or impossible to calculate in the normal manner, the terms of a particular indexed security may allow us to delay determining the amount payable as principal or interest on an indexed debt security or the settlement value of an indexed warrant or purchase contract, or we may use an alternative method to determine the value of the unavailable index.

Alternative methods of valuation are generally intended to produce a value similar to the value resulting from reference to the relevant index.

However, it is unlikely that any alternative method of valuation we use will produce a value identical to the value that the actual index would produce. If we use an alternative method of valuation for

a security linked to an index of this kind, the value of the security, or the rate of return on it, may be lower than it otherwise would be.

Some indexed securities are linked to indices that are not commonly used or that have been developed only recently. The lack of a trading history may make it difficult to anticipate the volatility or other risks associated with an indexed security of this kind. In addition, trading in these indices or their underlying stocks, commodities or currencies or other instruments or measures, or options or futures contracts on these stocks, commodities or currencies or other instruments or measures, may be limited, which could increase their volatility and decrease the value of the related indexed securities or the rates of return on them.

We May Engage in Hedging Activities that Could Adversely Affect an Indexed Security

In order to hedge an exposure on a particular indexed security, we may, directly or through our affiliates, enter into transactions involving the securities, commodities or currencies or other instruments or measures that underlie the index for that security, or derivative instruments, such as swaps, options or futures, on the index or any of its component items. By engaging in transactions of this kind, we could adversely affect the value of an indexed security. It is possible that we could achieve substantial returns from our hedging transactions while the value of the indexed security may decline.

Information About Indices May Not Be Indicative of Future Performance

If we issue an indexed security, we may include historical information about the relevant index in the applicable prospectus supplement. Any information about indices that we may provide will be furnished as a matter of information only, and you should not regard the information as indicative of the

range of, or trends in, fluctuations in the relevant index that may occur in the future.

We May Have Conflicts of Interest Regarding an Indexed Security

Zions Direct, Inc. and our other affiliates may have conflicts of interest with respect to some indexed securities. Zions Direct, Inc. and our other affiliates may engage in trading, including trading for hedging purposes, for their proprietary accounts or for other accounts under their management, in indexed securities and in the securities, commodities or currencies or other instruments or measures on which the index is based or in other derivative instruments related to the index or its component items. These trading activities could adversely

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affect the value of indexed securities. We and our affiliates may also issue or underwrite securities or derivative instruments that are linked to the same index as one or more indexed securities. By introducing competing products into the marketplace in this manner, we could adversely affect the value of an indexed security.

Zions Direct, Inc. or another of our affiliates may serve as calculation agent for the indexed securities and may have considerable discretion in calculating the amounts payable in respect of the securities. To the extent that Zions Direct, Inc. or another of our affiliates calculates or compiles a particular index, it may also have considerable discretion in performing the calculation or compilation of the index. Exercising discretion in this manner could adversely affect the value of an indexed security based on the index or the rate of return on the security.

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UNITED STATES TAXATION

This section describes the material United States federal income tax consequences of owning certain of the debt securities, preferred stock, depositary shares we are offering and the capital securities that the Issuer Trusts are offering. The material United States federal income tax consequences of owning the debt securities described below under Taxation of Debt Securities United States Holders Indexed and Other Debt Securities, of owning preferred stock that may be convertible into or exercisable or exchangeable for securities or other property, of owning capital securities that contain, or that represent any subordinated debt security that contains, any material term not described in this prospectus or of owning employee stock option rights units, warrants, purchase contracts and units will be described in the applicable prospectus supplement. This section is the opinion of Sullivan & Cromwell LLP, United States tax counsel to Zions. It applies to you only if you hold your securities as capital assets for tax purposes. This section does not apply to you if you are a member of a class of holders subject to special rules, such as:

a dealer in securities or currencies;

a trader in securities that elects to use a mark-to-market method of accounting for your securities holdings;

a bank;

an insurance company;

a thrift institution;

a regulated investment company;

a tax-exempt organization;

a person that owns debt securities that are a hedge or that are hedged against interest rate or currency risks;

a person that owns debt securities as part of a straddle or conversion transaction for tax purposes; or

a person whose functional currency for tax purposes is not the U.S. dollar.

This section is based on the U.S. Internal Revenue Code of 1986, as amended, its legislative history, existing and proposed regulations under the Internal Revenue Code, published rulings and court decisions, all as currently in effect. These laws are subject to change, possibly on a retroactive basis.

If a partnership holds the debt securities, the United States federal income tax treatment of a partner will generally depend on the status of the partner and the tax treatment of the partnership. A partner in a partnership holding the debt securities should consult its tax advisor with regard to the United States federal income tax treatment of an investment in the debt securities.

Please consult your own tax advisor concerning the consequences of owning these securities in your particular circumstances under the Internal Revenue Code and the laws of any other taxing jurisdiction.

Taxation of Debt Securities

This subsection describes the material United States federal

income tax consequences of owning, selling and disposing of the debt securities we are offering, other than the debt securities described below under United States Holders Indexed and Other Debt Securities , which will be described in the applicable prospectus supplement. It deals only with debt securities that are due to mature 30 years or less from the date on which they are issued. The United States federal income tax consequences of owning debt securities that are due to mature more than 30 years from their date of issue will be discussed in the applicable prospectus supplement.

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United States Holders.

This subsection describes the tax consequences to a United States holder. You are a United States holder if you are a beneficial owner of a debt security and you are:

a citizen or resident of the United States;

a domestic corporation;

an estate whose income is subject to United States federal income tax regardless of its source; or

a trust if a United States court can exercise primary supervision over the trust's administration and one or more United States persons are authorized to control all substantial decisions of the trust.

If you are not a United States holder, this section does not apply to you and you should refer to United States Alien Holders below.

Payments of Interest.

Except as described below in the case of interest on an original issue discount debt security that is not qualified stated interest, each as defined below under United States Holders' Original Issue Discount, you will be taxed on any interest on your debt security, whether payable in U.S. dollars or a non-U.S. dollar currency, including a composite currency or basket of currencies other than U.S. dollars, as ordinary income at the time you receive the interest or when it accrues, depending on your method of accounting for tax purposes.

Cash Basis Taxpayers.

If you are a taxpayer that uses the cash receipts and disbursements method of accounting for tax purposes and you receive an interest payment that is denominated in, or determined by reference to, a non-U.S. dollar currency, you must recognize income equal to the U.S. dollar value of the interest payment, based on the exchange rate in effect on the date of receipt, regardless of whether you actually convert the payment into U.S. dollars.

Accrual Basis Taxpayers.

If you are a taxpayer that uses an accrual method of accounting for tax purposes, you may determine the amount of income that you recognize with respect to an interest payment denominated in, or determined by reference to, a non-U.S. dollar currency by using one of two methods. Under the first method, you will determine the amount of income accrued based on the average exchange rate in effect during the interest accrual period or, with respect to an accrual period that spans two taxable years, that part of the period within the taxable year.

If you elect the second method, you would determine the amount of income accrued on the basis of the exchange rate in effect on the last day of the accrual period, or, in the case of an accrual period that spans two taxable years, the exchange rate in effect on the last day of the part of the period within the taxable year. Additionally, under this second method, if you receive a payment of interest within five business days of the last day of your accrual period or taxable year, you may instead translate the interest accrued into U.S. dollars at the exchange rate in effect on the day that you actually receive the interest payment. If you elect the second method, it will apply to all debt instruments that you hold at the beginning of the first taxable year to which the election applies and to all debt instruments that you subsequently acquire. You may not revoke this election without the

consent of the United States Internal
Revenue Service.

When you actually receive an
interest payment, including a
payment attributable to accrued but
unpaid interest upon the sale or
retirement of your debt security,
denominated in, or determined by
reference to, a non-U.S. dollar
currency for which you accrued an
amount of income, you will
recognize ordinary income or

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loss measured by the difference, if any, between the exchange rate that you used to accrue interest income and the exchange rate in effect on the date of receipt, regardless of whether you actually convert the payment into U.S. dollars.

Original Issue Discount.

If you own a debt security, other than a short-term debt security with a term of one year or less, it will be treated as an original issue discount debt security if the amount by which the debt security's stated redemption price at maturity exceeds its issue price is more than a de minimis amount. Generally, a debt security's issue price will be the first price at which a substantial amount of debt securities included in the issue of which the debt security is a part is sold to persons other than bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents, or wholesalers. A debt security's stated redemption price at maturity is the total of all payments provided by the debt security that are not payments of qualified stated interest. Generally, an interest payment on a debt security is qualified stated interest if it is one of a series of stated interest payments on a debt security that are unconditionally payable at least annually at a single fixed rate, with certain exceptions for lower rates paid during some periods, applied to the outstanding principal amount of the debt security. There are special rules for variable rate debt securities that are discussed below under **Variable Rate Debt Securities**.

In general, your debt security is not an original issue discount debt security if the amount by which its stated redemption price at maturity exceeds its issue price is less than the de minimis amount of 0.25 percent of its stated redemption price at maturity multiplied by the number of complete years to its

maturity. Your debt security will have de minimis original issue discount if the amount of the excess is less than the de minimis amount. If your debt security has de minimis original issue discount, you must include the de minimis amount in income as stated principal payments are made on the debt security, unless you make the election described below under Election to Treat All Interest as Original Issue Discount . You can determine the includible amount with respect to each such payment by multiplying the total amount of your debt security s de minimis original issue discount by a fraction equal to:

the amount of the principal payment made divided by:

the stated principal amount of the debt security.

Generally, if your original issue discount debt security matures more than one year from its date of issue, you must include original issue discount in income before you receive cash attributable to that income. The amount of original issue discount that you must include in income is calculated using a constant-yield method, and generally you will include increasingly greater amounts of original issue discount in income over the life of your debt security. More specifically, you can calculate the amount of original issue discount that you must include in income by adding the daily portions of original issue discount with respect to your original issue discount debt security for each day during the taxable year or portion of the taxable year that you hold your original issue discount debt security. You can determine the daily portion by allocating to each day in any accrual period a pro rata portion of the original issue discount allocable to that accrual period. You may select an accrual period of any length with respect to your original issue discount debt security and you may vary the length of each accrual period over

the term of your original issue discount debt security. However, no accrual period may be longer than one year and each scheduled payment of interest or principal on the original issue discount debt security must occur on either the first or final day of an accrual period.

You can determine the amount of original issue discount allocable to an accrual period by:

multiplying your original issue discount debt security's adjusted issue price at the beginning of the accrual period by your debt security's yield to maturity; and then

subtracting from this figure the sum of the payments of qualified stated interest on your debt security allocable to the accrual period.

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You must determine the original issue discount debt security's yield to maturity on the basis of compounding at the close of each accrual period and adjusting for the length of each accrual period.

Further, you determine your original issue discount debt security's adjusted issue price at the beginning of any accrual period by:

adding your original issue discount debt security's issue price and any accrued original issue discount for each prior accrual period; and then

subtracting any payments previously made on your original issue discount debt security that were not qualified stated interest payments.

If an interval between payments of qualified stated interest on your original issue discount debt security contains more than one accrual period, then, when you determine the amount of original issue discount allocable to an accrual period, you must allocate the amount of qualified stated interest payable at the end of the interval, including any qualified stated interest that is payable on the first day of the accrual period immediately following the interval, pro rata to each accrual period in the interval based on their relative lengths. In addition, you must increase the adjusted issue price at the beginning of each accrual period in the interval by the amount of any qualified stated interest that has accrued prior to the first day of the accrual period but that is not payable until the end of the interval.

You may compute the amount of original issue discount allocable to an initial short accrual period by using any reasonable method if all other accrual periods, other than a final short accrual period, are of equal length.

The amount of original issue discount allocable to the final accrual period is equal to the difference between:

the amount payable at the maturity of your debt security, other than any payment of qualified stated interest; and

your debt security's adjusted issue price as of the beginning of the final accrual period.

Acquisition Premium.

If you purchase your debt security for an amount that is less than or equal to the sum of all amounts, other than qualified stated interest, payable on your debt security after the purchase date but is greater than the amount of your debt security's adjusted issue price, as determined above, the excess is acquisition premium. If you do not make the election described below under Election to Treat All Interest as Original Issue Discount, then you must reduce the daily portions of original issue discount by a fraction equal to:

the excess of your adjusted basis in the debt security immediately after purchase over the adjusted issue price of the debt security divided by:

the excess of the sum of all amounts payable, other than qualified stated interest, on the debt security after the purchase date over the debt security's adjusted issue price.

Pre-Issuance Accrued Interest.

An election may be made to decrease the issue price of your debt security by the amount of pre-issuance accrued interest if:

a portion of the initial purchase price of your debt security is attributable to pre-issuance accrued interest;

the first stated interest payment on your debt security is to be made within one year of your debt security's issue date; and

the payment will equal or exceed the amount of pre-issuance accrued interest.

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If this election is made, a portion of the first stated interest payment will be treated as a return of the excluded pre-issuance accrued interest and not as an amount payable on your debt security.

Debt Securities Subject to Contingencies Including Optional Redemption.

Your debt security is subject to a contingency if it provides for an alternative payment schedule or schedules applicable upon the occurrence of a contingency or contingencies, other than a remote or incidental contingency, whether such contingency relates to payments of interest or of principal. In such a case, you must determine the yield and maturity of your debt security by assuming that the payments will be made according to the payment schedule most likely to occur if:

the timing and amounts of the payments that comprise each payment schedule are known as of the issue date; and

one of such schedules is significantly more likely than not to occur.

If there is no single payment schedule that is significantly more likely than not to occur, other than because of a mandatory sinking fund, you must include income on your debt security in accordance with the general rules that govern contingent payment obligations. These rules will be discussed in the applicable prospectus supplement.

Notwithstanding the general rules for determining yield and maturity, if your debt security is subject to contingencies, and either you or we have an unconditional option or options that, if exercised, would require payments to be made on the debt security under an alternative

payment schedule or schedules,
then:

in the case of an option or
options that we may exercise,
we will be deemed to exercise or
not exercise an option or
combination of options in the
manner that minimizes the yield
on your debt security; and

in the case of an option or
options that you may exercise,
you will be deemed to exercise
or not exercise an option or
combination of options in the
manner that maximizes the yield
on your debt security.

If both you and we hold options
described in the preceding sentence,
those rules will apply to each option
in the order in which they may be
exercised. You may determine the
yield on your debt security for the
purposes of those calculations by
using any date on which your debt
security may be redeemed or
repurchased as the maturity date
and the amount payable on the date
that you chose in accordance with
the terms of your debt security as
the principal amount payable at
maturity.

If a contingency, including the
exercise of an option, actually
occurs or does not occur contrary to
an assumption made according to
the above rules then, except to the
extent that a portion of your debt
security is repaid as a result of this
change in circumstances and solely
to determine the amount and accrual
of original issue discount, you must
redetermine the yield and maturity
of your debt security by treating
your debt security as having been
retired and reissued on the date of
the change in circumstances for an
amount equal to your debt security's
adjusted issue price on that date.

***Election to Treat All Interest as
Original Issue Discount.***

You may elect to include in gross
income all interest that accrues on

your debt security using the constant-yield method described above, with the modifications described below. For purposes of this election, interest will include stated interest, original issue discount, de minimis original issue discount, market discount, de minimis market discount and unstated interest, as adjusted by any amortizable bond premium, described below under Taxation of Debt Securities. United States Holders. Market Discount. Debt Securities Purchased at a Premium, or acquisition premium.

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If you make this election for your debt security, then, when you apply the constant-yield method:

the issue price of your debt security will equal your cost;

the issue date of your debt security will be the date you acquired it; and

no payments on your debt security will be treated as payments of qualified stated interest.

Generally, this election will apply only to the debt security for which you make it; however, if the debt security has amortizable bond premium, you will be deemed to have made an election to apply amortizable bond premium against interest for all debt instruments with amortizable bond premium, other than debt instruments the interest on which is excludible from gross income, that you hold as of the beginning of the taxable year to which the election applies or any taxable year thereafter.

Additionally, if you make this election for a market discount debt security, you will be treated as having made the election discussed below under Taxation of Debt Securities United States Holders Market Discount to include market discount in income currently over the life of all debt instruments that you currently own or later acquire. You may not revoke any election to apply the constant-yield method to all interest on a debt security or the deemed elections with respect to amortizable bond premium or market discount debt securities without the consent of the United States Internal Revenue Service.

Variable Rate Debt Securities.

Your debt security will be a variable
rate debt security if:

your debt security's issue price
does not exceed the total
noncontingent principal
payments by more than the
lesser of:

.015 multiplied by the product
of the total noncontingent
principal payments and the
number of complete years to
maturity from the issue
date; or

15 percent of the total
noncontingent principal
payments; and

your debt security provides for
stated interest, compounded or
paid at least annually, only at:

one or more qualified floating
rates;

a single fixed rate and one or
more qualified floating rates;

a single objective rate; or

a single fixed rate and a single
objective rate that is a qualified
inverse floating rate.

Your debt security will have a
variable rate that is a qualified
floating rate if:

variations in the value of the rate
can reasonably be expected to
measure contemporaneous
variations in the cost of newly
borrowed funds in the currency
in which your debt security is
denominated; or

the rate is equal to such a rate multiplied by either:

a fixed multiple that is greater than 0.65 but not more than 1.35; or

a fixed multiple greater than 0.65 but not more than 1.35, increased or decreased by a fixed rate; and

the value of the rate on any date during the term of your debt security is set no earlier than three months prior to the first day on which that value is in effect and no later than one year following that first day.

If your debt security provides for two or more qualified floating rates that are within 0.25 percentage points of each other on the issue date or can reasonably be expected to have approximately the same values throughout the term of the debt security, the qualified floating rates together constitute a single qualified floating rate.

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Your debt security will not have a qualified floating rate, however, if the rate is subject to certain restrictions (including caps, floors, governors, or other similar restrictions) unless such restrictions are fixed throughout the term of the debt security or are not reasonably expected to significantly affect the yield on the debt security.

Your debt security will have a variable rate that is a single objective rate if:

the rate is not a qualified floating rate;

the rate is determined using a single, fixed formula that is based on objective financial or economic information that is not within the control of or unique to the circumstances of the issuer or a related party; and

the value of the rate on any date during the term of your debt security is set no earlier than three months prior to the first day on which that value is in effect and no later than one year following that first day.

Your debt security will not have a variable rate that is an objective rate, however, if it is reasonably expected that the average value of the rate during the first half of your debt security's term will be either significantly less than or significantly greater than the average value of the rate during the final half of your debt security's term.

An objective rate as described above is a qualified inverse floating rate if:

the rate is equal to a fixed rate
minus a qualified floating
rate and

the variations in the rate can
reasonably be expected to
inversely reflect
contemporaneous variations in
the cost of newly borrowed
funds.

Your debt security will also have a
single qualified floating rate or an
objective rate if interest on your
debt security is stated at a fixed rate
for an initial period of one year or
less followed by either a qualified
floating rate or an objective rate for
a subsequent period, and either:

the fixed rate and the qualified
floating rate or objective rate
have values on the issue date of
the debt security that do not
differ by more than
0.25 percentage points; or

the value of the qualified
floating rate or objective rate is
intended to approximate the
fixed rate.

In general, if your variable rate debt
security provides for stated interest
at a single qualified floating rate or
objective rate, or one of those rates
after a single fixed rate for an initial
period, all stated interest on your
debt security is qualified stated
interest. In this case, the amount of
original issue discount, if any, is
determined by using, in the case of
a qualified floating rate or qualified
inverse floating rate, the value as of
the issue date of the qualified
floating rate or qualified inverse
floating rate, or, for any other
objective rate, a fixed rate that
reflects the yield reasonably
expected for your debt security.

If your variable rate debt security
does not provide for stated interest
at a single qualified floating rate or
a single objective rate, and also
does not provide for interest
payable at a fixed rate other than a
single fixed rate for an initial

period, you generally must
determine the interest and original
issue discount accruals on your debt
security by:

determining a fixed rate
substitute for each variable rate
provided under your variable
rate debt security;

constructing the equivalent fixed
rate debt instrument, using the
fixed rate substitute described
above;

determining the amount of
qualified stated interest and
original issue discount with
respect to the equivalent fixed
rate debt instrument; and

adjusting for actual variable
rates during the applicable
accrual period.

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When you determine the fixed rate substitute for each variable rate provided under the variable rate debt security, you generally will use the value of each variable rate as of the issue date or, for an objective rate that is not a qualified inverse floating rate, a rate that reflects the reasonably expected yield on your debt security.

If your variable rate debt security provides for stated interest either at one or more qualified floating rates or at a qualified inverse floating rate, and also provides for stated interest at a single fixed rate other than at a single fixed rate for an initial period, you generally must determine interest and original issue discount accruals by using the method described in the previous paragraph. However, your variable rate debt security will be treated, for purposes of the first three steps of the determination, as if your debt security had provided for a qualified floating rate, or a qualified inverse floating rate, rather than the fixed rate. The qualified floating rate, or qualified inverse floating rate, that replaces the fixed rate must be such that the fair market value of your variable rate debt security as of the issue date approximates the fair market value of an otherwise identical debt instrument that provides for the qualified floating rate, or qualified inverse floating rate, rather than the fixed rate.

Short-Term Debt Securities.

In general, if you are an individual or other cash basis United States holder of a short-term debt security, you are not required to accrue original issue discount, as specially defined below for the purposes of this paragraph, for United States federal income tax purposes unless you elect to do so (although it is possible that you may be required to include any stated interest in income as you receive it). If you are an accrual basis taxpayer, a taxpayer in a special class, including, but not limited to, a

regulated investment company, common trust fund, or a certain type of pass-through entity, or a cash basis taxpayer who so elects, you will be required to accrue original issue discount on short-term debt securities on either a straight-line basis or under the constant-yield method, based on daily compounding. If you are not required and do not elect to include original issue discount in income currently, any gain you realize on the sale or retirement of your short-term debt security will be ordinary income to the extent of the accrued original issue discount, which will be determined on a straight-line basis unless you make an election to accrue the original issue discount under the constant-yield method, through the date of sale or retirement. However, if you are not required and do not elect to accrue original issue discount on your short-term debt securities, you will be required to defer deductions for interest on borrowings allocable to your short-term debt securities in an amount not exceeding the deferred income until the deferred income is realized.

When you determine the amount of original issue discount subject to these rules, you must include all interest payments on your short-term debt security, including stated interest, in your short-term debt security's stated redemption price at maturity.

***Non-U.S. Dollar Currency
Original Issue Discount Debt
Securities.***

If your original issue discount debt security is denominated in, or determined by reference to, a non-U.S. dollar currency, you must determine original issue discount for any accrual period on your original issue discount debt security in the non-U.S. dollar currency and then translate the amount of original issue discount into U.S. dollars in the same manner as stated interest accrued by an accrual basis United States holder, as described above under Taxation of Debt

Securities United States
Holders Payments of Interest . You
may recognize ordinary income or
loss when you receive an amount
attributable to original issue
discount in connection with a
payment of interest or the sale or
retirement of your debt security.

Market Discount.

You will be treated as if you
purchased your debt security, other
than a short-term debt security, at a
market discount, and your debt
security will be a market discount
debt security if:

you purchase your debt security
for less than its issue price as
determined above; and

the difference between the debt
security's stated redemption price
at maturity or, in the case of an
original issue discount debt
security, the debt security's
revised issue price, and the price
you paid for

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your debt security is equal to or greater than 0.25 percent of your debt security's stated redemption price at maturity or revised issue price, respectively, multiplied by the number of complete years to the debt security's maturity. To determine the revised issue price of your debt security for these purposes, you generally add any original issue discount that has accrued on your debt security to its issue price.

If your debt security's stated redemption price at maturity or, in the case of an original issue discount debt security, its revised issue price, exceeds the price you paid for the debt security by less than 0.25 percent multiplied by the number of complete years to the debt security's maturity, the excess constitutes de minimis market discount, and the rules discussed below are not applicable to you.

You must treat any gain you recognize on the maturity or disposition of your market discount debt security as ordinary income to the extent of the accrued market discount on your debt security.

Alternatively, you may elect to include market discount in income currently over the life of your debt security. If you make this election, it will apply to all debt instruments with market discount that you acquire on or after the first day of the first taxable year to which the election applies. You may not revoke this election without the consent of the United States Internal Revenue Service. If you own a market discount debt security and do not make this election, you will generally be required to defer deductions for interest on borrowings allocable to your debt security in an amount not exceeding the accrued market discount on your debt security until the maturity or disposition of your debt security.

You will accrue market discount on your market discount debt security on a straight-line basis unless you elect to accrue market discount

using a constant-yield method. If you make this election, it will apply only to the debt security with respect to which it is made and you may not revoke it.

Debt Securities Purchased at a Premium.

If you purchase your debt security for an amount in excess of its principal amount, you may elect to treat the excess as amortizable bond premium. If you make this election, you will reduce the amount required to be included in your income each year with respect to interest on your debt security by the amount of amortizable bond premium allocable to that year, based on your debt security's yield to maturity. If your debt security is denominated in, or determined by reference to, a non-U.S. dollar currency, you will compute your amortizable bond premium in units of the non-U.S. dollar currency and your amortizable bond premium will reduce your interest income in units of the non-U.S. dollar currency.

Gain or loss recognized that is attributable to changes in foreign currency exchange rates between the time your amortized bond premium offsets interest income and the time of the acquisition of your debt security is generally taxable as ordinary income or loss. If you make an election to amortize bond premium, it will apply to all debt instruments, other than debt instruments the interest on which is excludible from gross income, that you hold at the beginning of the first taxable year to which the election applies or that you thereafter acquire, and you may not revoke it without the consent of the United States Internal Revenue Service. See also *Taxation of Debt Securities*, United States Holders' Original Issue Discount Election to Treat All Interest as Original Issue Discount.

Purchase, Sale and Retirement of the Debt Securities.

Your tax basis in your debt security will generally be the U.S. dollar cost, as defined below, of your debt

security, adjusted by:

adding any original issue
discount, market discount, de
minimis original issue discount
and de minimis market discount
previously included in income
with respect to your debt
security; and then

subtracting any payments on
your debt security that are not
qualified stated interest
payments and any amortizable
bond premium applied to reduce
interest on your debt security.
If you purchase your debt security
with non-U.S. dollar currency, the
U.S. dollar cost of your debt
security will generally be the
U.S. dollar value of the purchase
price on the date of purchase.
However, if you are a cash

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basis taxpayer, or an accrual basis taxpayer if you so elect, and your debt security is traded on an established securities market, as defined in the applicable U.S. Treasury regulations, the U.S. dollar cost of your debt security will be the U.S. dollar value of the purchase price on the settlement date of your purchase.

You will generally recognize gain or loss on the sale or retirement of your debt security equal to the difference between the amount you realize on the sale or retirement and your tax basis in your debt security.

If your debt security is sold or retired for an amount in non-U.S. dollar currency, the amount you realize will be the U.S. dollar value of such amount on the date the note is disposed of or retired, except that in the case of a note that is traded on an established securities market, as defined in the applicable Treasury regulations, a cash basis taxpayer, or an accrual basis taxpayer that so elects, will determine the amount realized based on the U.S. dollar value of the specified currency on the settlement date of the sale.

You will recognize capital gain or loss when you sell or retire your debt security, except to the extent:

described above under Taxation
of Debt Securities United States
Holders Original Issue
Discount Short-Term Debt
Securities or Market Discount ;

attributable to accrued but
unpaid interest;

the rules governing contingent
payment obligations apply; or

attributable to changes in
exchange rates as described
below.

Capital gain of a noncorporate
United States holder that is
recognized before January 1, 2009
is generally taxed at a maximum
rate of 15% where the holder has a
holding period greater than one
year.

You must treat any portion of the
gain or loss that you recognize on
the sale or retirement of a debt
security as ordinary income or loss
to the extent attributable to changes
in exchange rates. However, you
take exchange gain or loss into
account only to the extent of the
total gain or loss you realize on the
transaction.

***Exchange of Amounts in Other
Than U.S. Dollars.***

If you receive non-U.S. dollar
currency as interest on your debt
security or on the sale or retirement
of your debt security, your tax basis
in the non-U.S. dollar currency will
equal its U.S. dollar value when the
interest is received or at the time of
the sale or retirement. If you
purchase non-U.S. dollar currency,
you generally will have a tax basis
equal to the U.S. dollar value of the
non-U.S. dollar currency on the date
of your purchase. If you sell or
dispose of a non-U.S. dollar
currency, including if you use it to
purchase debt securities or
exchange it for U.S. dollars, any
gain or loss recognized generally
will be ordinary income or loss.

Indexed and Other Debt Securities.

The applicable prospectus
supplement will discuss the material
United States federal income tax
rules with respect to contingent
non-U.S. dollar currency debt
securities, debt securities that may
be convertible into or exercisable or
exchangeable for common or
preferred stock or other securities of
Zions or debt or equity securities of
one or more third parties, debt
securities the payments on which
are determined by reference to any
index and other debt securities that

are subject to the rules governing contingent payment obligations which are not subject to the rules governing variable rate debt securities, any renewable and extendible debt securities and any debt securities providing for the periodic payment of principal over the life of the debt security.

United States Alien Holders.

This subsection describes the tax consequences to a United States alien holder. You are a United States alien holder if you are the beneficial owner of a debt security and are, for United States federal income tax purposes:

a nonresident alien individual;

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a foreign corporation; or

an estate or trust that in either case is not subject to United States federal income tax on a net income basis on income or gain from a debt security.

If you are a United States holder, this section does not apply to you.

This discussion assumes that the debt security or coupon is not subject to the rules of Section 871(h)(4)(A) of the Internal Revenue Code, relating to interest payments that are determined by reference to the income, profits, changes in the value of property or other attributes of the debtor or a related party.

Under United States federal income and estate tax law, and subject to the discussion of backup withholding below, if you are a United States alien holder of a debt security or coupon:

we and other U.S. payors generally will not be required to deduct United States withholding tax from payments of principal, premium, if any, and interest, including original issue discount, to you if, in the case of payments of interest:

you do not actually or constructively own 10% or more of the total combined voting power of all classes of our stock entitled to vote;

you are not a controlled foreign corporation that is related to us through stock ownership;

you are not a bank receiving interest on an extension of credit made pursuant to a loan agreement entered into in the ordinary course of your trade or business;

in the case of a debt security other than a bearer debt security, the U.S. payor does not have actual knowledge or reason to know that you are a United States person and:

you have furnished to the U.S. payor an Internal Revenue Service Form W-8BEN or an acceptable substitute form upon which you certify, under penalties of perjury, that you are (or, in the case of a United States alien holder that is a partnership or an estate or trust, such forms certifying that each partner in the partnership or beneficiary of the estate or trust is) not a United States person;

in the case of payments made outside the United States to you at an offshore account (generally, an account maintained by you at a bank or other financial institution at any location outside the United States), you have furnished to the U.S. payor documentation that establishes your identity and your status as the beneficial owner of the payment for United States federal income tax purposes and as a person who is not a United States person;

the U.S. payor has received a withholding certificate (furnished on an appropriate Internal Revenue Service Form W-8 or an acceptable substitute form) from a person claiming to be:

a withholding foreign partnership (generally a foreign partnership that has entered into an agreement with the Internal Revenue Service to assume primary withholding responsibility with respect to distributions and guaranteed payments it makes to its partners);

a qualified intermediary (generally a non-United States financial institution or clearing organization or a non-United States branch or office of a United States financial institution or clearing organization that is a party to a withholding agreement with the Internal Revenue Service); or

a U.S. branch of a non-United States bank or of a non-United States insurance company; and
the withholding foreign partnership, qualified intermediary or U.S. branch has received documentation upon which it may rely to treat the payment as made to a person who is not a United States person that is, for United States federal income tax purposes, the beneficial owner of the payments on the debt securities in accordance

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with U.S. Treasury regulations (or,
in the case of a qualified
intermediary, in accordance with its
agreement with the Internal
Revenue Service);

the U.S. payor receives a
statement from a securities
clearing organization, bank or
other financial institution that
holds customers' securities in the
ordinary course of its trade or
business:

certifying to the U.S. payor
under penalties of perjury that
an Internal Revenue Service
Form W-8BEN or an
acceptable substitute form has
been received from you by it
or by a similar financial
institution between it and
you; and

to which is attached a copy of
the Internal Revenue Service
Form W-8BEN or acceptable
substitute form; or

the U.S. payor otherwise
possesses documentation upon
which it may rely to treat the
payment as made to a person
who is not a United States
person that is, for United States
federal income tax purposes, the
beneficial owner of the
payments on the debt securities
in accordance with
U.S. Treasury regulations; and

in the case of a bearer debt
security, the debt security is
offered, sold and delivered in
compliance with the restrictions
described above under
Considerations Relating to
Securities Issued in Bearer Form
and payments on the debt
security are made in accordance

with the procedures described
above under that section; and

no deduction for any United
States federal withholding tax
will be made from any gain that
you realize on the sale or
exchange of your debt security
or coupon.

Further, a debt security or coupon
held by an individual who at death
is not a citizen or resident of the
United States will not be includible
in the individual's gross estate for
United States federal estate tax
purposes if:

the decedent did not actually or
constructively own 10% or more
of the total combined voting
power of all classes of our stock
entitled to vote at the time of
death; and

the income on the debt security
would not have been effectively
connected with a U.S. trade or
business of the decedent at the
same time.

***Treasury Regulations Requiring
Disclosure of Reportable
Transactions.***

Pursuant to Treasury regulations,
United States taxpayers must report
certain transactions that give rise to
a loss in excess of certain thresholds
(a Reportable Transaction). Under
these regulations, if the debt
securities are denominated in a
foreign currency, a United States
holder (or a United States alien
holder that holds the debt securities
in connection with a U.S. trade or
business) that recognizes a loss with
respect to the debt securities that is
characterized as an ordinary loss
due to changes in currency
exchange rates (under any of the
rules discussed above) would be
required to report the loss on
Internal Revenue Service
Form 8886 (Reportable Transaction
Statement) if the loss exceeds the
thresholds set forth in the
regulations. For individuals and

trusts, this loss threshold is \$50,000 in any single taxable year. For other types of taxpayers and other types of losses, the thresholds are higher.

You should consult with your tax advisor regarding any tax filing and reporting obligations that may apply in connection with acquiring, owning and disposing of debt securities.

Backup Withholding and Information Reporting.

United States Holders. In general, if you are a noncorporate United States holder, we and other payors are required to report to the United States Internal Revenue Service all payments of principal, any premium and interest on your debt security, and the accrual of original issue discount on an original issue discount debt security. In addition, we and other payors are required to report to the United States Internal Revenue Service any

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payment of proceeds of the sale of your debt security before maturity within the United States. Additionally, backup withholding will apply to any payments, including payments of original issue discount, if you fail to provide an accurate taxpayer identification number, or you are notified by the United States Internal Revenue Service that you have failed to report all interest and dividends required to be shown on your federal income tax returns.

United States Alien Holders. In general, if you are a United States alien holder, payments of principal, premium or interest, including original issue discount, made by us and other payors to you will not be subject to backup withholding and information reporting, provided that the certification requirements described above under Taxation of Debt Securities United States Alien Holders are satisfied or you otherwise establish an exemption. However, we and other payors are required to report payments of interest on your debt securities on Internal Revenue Service Form 1042-S even if the payments are not otherwise subject to information reporting requirements. In addition, payment of the proceeds from the sale of debt securities effected at a United States office of a broker will not be subject to backup withholding and information reporting provided that:

the broker does not have actual knowledge or reason to know that you are a United States person and you have furnished to the broker:

an appropriate Internal Revenue Service Form W-8 or an acceptable substitute form upon which you certify, under penalties of perjury, that you are (or, in the case of a United

States alien holder that is a partnership or an estate or trust, such forms certifying that each partner in the partnership or beneficiary of the estate or trust is) not a United States person; or

other documentation upon which it may rely to treat the payment as made to a person who is not a United States person that is, for United States federal income tax purposes, the beneficial owner of the payment on the debt securities in accordance with U.S. Treasury regulations; or

you otherwise establish an exemption.

If you fail to establish an exemption and the broker does not possess adequate documentation of your status as a person who is not a United States person, the payments may be subject to information reporting and backup withholding. However, backup withholding will not apply with respect to payments made outside the United States to an offshore account maintained by you unless the broker has actual knowledge that you are a United States person.

In general, payment of the proceeds from the sale of debt securities effected at a foreign office of a broker will not be subject to information reporting or backup withholding. However, a sale effected at a foreign office of a broker will be subject to information reporting and backup withholding if:

the proceeds are transferred to an account maintained by you in the United States;

the payment of proceeds or the confirmation of the sale is mailed to you at a United States address; or

the sale has some other specified connection with the United States as provided in U.S. Treasury regulations; unless the broker does not have actual knowledge or reason to know that you are a United States person and the documentation requirements described above (relating to a sale of debt securities effected at a United States office of a broker) are met or you otherwise establish an exemption.

In addition, payment of the proceeds from the sale of debt securities effected at a foreign office of a broker will be subject to information reporting if the broker is:

a United States person;

a controlled foreign corporation for United States tax purposes;

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a foreign person 50% or more of whose gross income is effectively connected with the conduct of a United States trade or business for a specified three-year period; or

a foreign partnership, if at any time during its tax year:

one or more of its partners are U.S. persons, as defined in U.S. Treasury regulations, who in the aggregate hold more than 50% of the income or capital interest in the partnership; or

such foreign partnership is engaged in the conduct of a United States trade or business;

unless the broker does not have actual knowledge or reason to know that you are a United States person and the documentation requirements described above (relating to a sale of debt securities effected at a United States office of a broker) are met or you otherwise establish an exemption. Backup withholding will apply if the sale is subject to information reporting and the broker has actual knowledge that you are a United States person.

Taxation of Preferred Stock and Depositary Shares

This subsection describes the material United States federal income tax consequences of owning, selling and disposing of the preferred stock and depositary shares that we may offer other than preferred stock that may be convertible into or exercisable or exchangeable for securities or other property, which will be described in the applicable prospectus supplement. When we refer to preferred stock in this subsection, we mean both preferred stock and depositary shares.

United States Holders

This subsection describes the tax consequences to a United States holder. You are a United States holder if you are a beneficial owner of a share of preferred stock and you are:

a citizen or resident of the United States;

a domestic corporation;

an estate whose income is subject to United States federal income tax regardless of its source; or

a trust if a United States court can exercise primary supervision over the trust's administration and one or more United States persons are authorized to control all substantial decisions of the trust.

If you are not a United States holder, this subsection does not apply to you and you should refer to United States Alien Holders below.

Distributions on Preferred Stock.

You will be taxed on distributions on preferred stock as dividend income to the extent paid out of our current or accumulated earnings and profits for United States federal income tax purposes. If you are a noncorporate United States holder, dividends paid to you in taxable years beginning before January 1, 2009 that constitute qualified dividend income will be taxable to you at a maximum rate of 15%, provided that you hold your shares of preferred stock for more than 60 days during the 121-day period beginning 60 days before the ex-dividend date or, if the dividend is attributable to a period or periods aggregating over 366 days, provided that you hold your shares of preferred stock for more than

90 days during the 181-day period beginning 90 days before the ex-dividend date. If you are taxed as a corporation, except as described in the next subsection, dividends would be eligible for the 70% dividends-received deduction.

You generally will not be taxed on any portion of a distribution not paid out of our current or accumulated earnings and profits if your tax basis in the preferred stock is greater than or equal to the amount of the distribution. However, you would be required to reduce your tax basis (but not below zero) in the preferred stock

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by the amount of the distribution, and would recognize capital gain to the extent that the distribution exceeds your tax basis in the preferred stock. Further, if you are a corporation, you would not be entitled to a dividends-received deduction on this portion of a distribution.

Limitations on Dividends-Received Deduction

Corporate shareholders may not be entitled to take the 70% dividends-received deduction in all circumstances. Prospective corporate investors in preferred stock should consider the effect of:

Section 246A of the Internal Revenue Code, which reduces the dividends-received deduction allowed to a corporate shareholder that has incurred indebtedness that is directly attributable to an investment in portfolio stock such as preferred stock;

Section 246(c) of the Internal Revenue Code, which, among other things, disallows the dividends-received deduction in respect of any dividend on a share of stock that is held for less than the minimum holding period (generally at least 46 days during the 90 day period beginning on the date which is 45 days before the date on which such share becomes ex-dividend with respect to such dividend); and

Section 1059 of the Internal Revenue Code, which, under certain circumstances, reduces the basis of stock for purposes of calculating gain or loss in a subsequent disposition by the portion of any extraordinary

dividend (as defined below) that is eligible for the dividends-received deduction.

Extraordinary Dividends

If you are a corporate shareholder, you will be required to reduce your tax basis (but not below zero) in the preferred stock by the nontaxed portion of any extraordinary dividend if you have not held your stock for more than two years before the earliest of the date such dividend is declared, announced, or agreed. Generally, the nontaxed portion of an extraordinary dividend is the amount excluded from income by operation of the dividends-received deduction. An extraordinary dividend on the preferred stock generally would be a dividend that:

equals or exceeds 5% of the corporate shareholder's adjusted tax basis in the preferred stock, treating all dividends having ex-dividend dates within an 85 day period as one dividend; or

exceeds 20% of the corporate shareholder's adjusted tax basis in the preferred stock, treating all dividends having ex-dividend dates within a 365 day period as one dividend.

In determining whether a dividend paid on the preferred stock is an extraordinary dividend, a corporate shareholder may elect to substitute the fair market value of the stock for its tax basis for purposes of applying these tests if the fair market value as of the day before the ex-dividend date is established to the satisfaction of the Secretary of the Treasury. An extraordinary dividend also includes any amount treated as a dividend in the case of a redemption that is either non-pro rata as to all stockholders or in partial liquidation of the company, regardless of the stockholder's holding period and regardless of the size of the dividend. Any part of the nontaxed portion of an extraordinary dividend that is not

applied to reduce the corporate shareholder's tax basis as a result of the limitation on reducing its basis below zero would be treated as capital gain and would be recognized in the taxable year in which the extraordinary dividend is received.

If you are a corporate shareholder, please consult your tax advisor with respect to the possible application of the extraordinary dividend provisions of the federal income tax law to your ownership or disposition of preferred stock in your particular circumstances.

Redemption Premium

If we may redeem your preferred stock at a redemption price in excess of its issue price, the entire amount of the excess may constitute an unreasonable redemption premium which will be treated as a constructive

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dividend. You generally must take this constructive dividend into account each year in the same manner as original issue discount would be taken into account if the preferred stock were treated as an original issue discount debt security for United States federal income tax purposes. See Taxation of Debt Securities United States Holders Original Issue Discount above for a discussion of the special tax rules for original issue discount. A corporate shareholder would be entitled to a dividends-received deduction for any constructive dividends unless the special rules denying a dividends-received deduction described above in Limitations on Dividends-Received Deduction apply. A corporate shareholder would also be required to take these constructive dividends into account when applying the extraordinary dividend rules described above. Thus, a corporate shareholder's receipt of a constructive dividend may cause some or all stated dividends to be treated as extraordinary dividends. The applicable prospectus supplement for preferred stock that is redeemable at a price in excess of its issue price will indicate whether tax counsel believes that a shareholder must include any redemption premium in income.

Sale or Exchange of Preferred Stock Other Than by Redemption.

If you sell or otherwise dispose of your preferred stock (other than by redemption), you will generally recognize capital gain or loss equal to the difference between the amount realized upon the disposition and your adjusted tax basis of the preferred stock. Capital gain of a noncorporate United States holder that is recognized before January 1, 2009 is generally taxed at a maximum rate of 15% where the holder has a holding period greater than one year.

Redemption of Preferred Stock.

If we are permitted to and redeem your preferred stock, it generally would be a taxable event. You would be treated as if you had sold your preferred stock if the redemption:

results in a complete termination of your stock interest in us;

is substantially disproportionate with respect to you; or

is not essentially equivalent to a dividend with respect to you. In determining whether any of these tests has been met, shares of stock considered to be owned by you by reason of certain constructive ownership rules set forth in Section 318 of the Internal Revenue Code, as well as shares actually owned, must be taken into account.

If we redeem your preferred stock in a redemption that meets one of the tests described above, you generally would recognize taxable gain or loss equal to the sum of the amount of cash and fair market value of property (other than stock of us or a successor to us) received by you less your tax basis in the preferred stock redeemed. This gain or loss would be long-term capital gain or capital loss if you have held the preferred stock for more than one year.

If a redemption does not meet any of the tests described above, you generally would be taxed on the cash and fair market value of the property you receive as a dividend to the extent paid out of our current and accumulated earnings and profits. Any amount in excess of our current or accumulated earnings and profits would first reduce your tax basis in the preferred stock and thereafter would be treated as capital gain. If a redemption of the preferred stock is treated as a distribution that is taxable as a dividend, your basis in the redeemed preferred stock would be

transferred to the remaining shares
of our stock that you own, if any.

Special rules apply if we redeem
preferred stock for our debt
securities. We will discuss these
rules in an applicable prospectus
supplement if we have the option to
redeem your preferred stock for our
debt securities.

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United States Alien Holders

This section summarizes certain United States federal income and estate tax consequences of the ownership and disposition of preferred stock by a United States alien holder. You are a United States alien holder if you are, for United States federal income tax purposes:

a nonresident alien individual;

a foreign corporation; or

an estate or trust that in either case is not subject to United States federal income tax on a net income basis on income or gain from preferred stock.

Dividends

Except as described below, if you are a United States alien holder of preferred stock, dividends paid to you are subject to withholding of United States federal income tax at a 30% rate or at a lower rate if you are eligible for the benefits of an income tax treaty that provides for a lower rate. Even if you are eligible for a lower treaty rate, we and other payors will generally be required to withhold at a 30% rate (rather than the lower treaty rate) on dividend payments to you, unless you have furnished to us or another payor:

a valid Internal Revenue Service Form W-8BEN or an acceptable substitute form upon which you certify, under penalties of perjury, your status as a person (or, in the case of a United States alien holder that is a partnership or an estate or trust, such forms certifying that each partner in the partnership or beneficiary of the estate or trust

is) who is not a United States person and your entitlement to the lower treaty rate with respect to such payments; or

in the case of payments made outside the United States to an offshore account (generally, an account maintained by you at an office or branch of a bank or other financial institution at any location outside the United States), other documentary evidence establishing your entitlement to the lower treaty rate in accordance with U.S. Treasury regulations.

If you are eligible for a reduced rate of United States withholding tax under a tax treaty, you may obtain a refund of any amounts withheld in excess of that rate by filing a refund claim with the United States Internal Revenue Service.

If dividends paid to you are effectively connected with your conduct of a trade or business within the United States, and, if required by a tax treaty, the dividends are attributable to a permanent establishment that you maintain in the United States, we and other payors generally are not required to withhold tax from the dividends, provided that you have furnished to us or another payor a valid Internal Revenue Service Form W-8ECI or an acceptable substitute form upon which you represent, under penalties of perjury, that:

you (or, in the case of a United States alien holder that is a partnership or an estate or trust, such forms certifying that each partner in the partnership or beneficiary of the estate or trust is) are not a United States person; and

the dividends are effectively connected with your conduct of a trade or business within the United States and are includible

in your gross income.

Effectively connected dividends are taxed at rates applicable to United States citizens, resident aliens and domestic United States corporations.

If you are a corporate United States alien holder, effectively connected dividends that you receive may, under certain circumstances, be subject to an additional branch profits tax at a 30% rate or at a lower rate if you are eligible for the benefits of an income tax treaty that provides for a lower rate.

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Gain on Disposition of Preferred Stock

If you are a United States alien holder, you generally will not be subject to United States federal income tax on gain that you recognize on a disposition of preferred stock unless:

the gain is effectively connected with your conduct of a trade or business in the United States, and the gain is attributable to a permanent establishment that you maintain in the United States, if that is required by an applicable income tax treaty as a condition for subjecting you to United States taxation on a net income basis;

you are an individual, you hold the preferred stock as a capital asset, you are present in the United States for 183 or more days in the taxable year of the sale and certain other conditions exist; or we are or have been a United States real property holding corporation for federal income tax purposes and you held, directly or indirectly, at any time during the five-year period ending on the date of disposition, more than 5% of your class of preferred stock and you are not eligible for any treaty exemption.

If you are a corporate United States alien holder, effectively connected gains that you recognize may also, under certain circumstances, be subject to an additional branch profits tax at a 30% rate or at a lower rate if you are eligible for the benefits of an income tax treaty that provides for a lower rate.

We have not been, are not and do not anticipate becoming a United States real property holding corporation for United States federal income tax purposes.

Federal Estate Taxes

Preferred stock held by a United States alien holder at the time of death will be included in the holder's gross estate for United States federal estate tax purposes, unless an applicable estate tax treaty provides otherwise.

Backup Withholding and Information Reporting

United States Holders. In general, dividend payments, or other taxable distributions, made within the United States to you will be subject to information reporting requirements and backup withholding tax if you are a non-corporate United States person and you:

fail to provide an accurate taxpayer identification number;

are notified by the United States Internal Revenue Service that you have failed to report all interest or dividends required to be shown on your federal income tax returns; or

in certain circumstances, fail to comply with applicable certification requirements.

If you sell your preferred stock outside the United States through a non-U.S. office of a non-U.S. broker, and the sales proceeds are paid to you outside the United States, then U.S. backup withholding and information reporting requirements generally will not apply to that payment.

However, U.S. information reporting, but not backup withholding, will apply to a payment of sales proceeds, even if that payment is made outside the United States, if you sell your preferred stock through a non-U.S. office of a broker that is:

a United States person;

a controlled foreign corporation
for United States tax purposes;

a foreign person 50% or more of
whose gross income is
effectively connected with the
conduct of a United States trade
or business for a specified
three-year period; or

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a foreign partnership, if at any time during its tax year:

one or more of its partners are U.S. persons, as defined in U.S. Treasury regulations, who in the aggregate hold more than 50% of the income or capital interest in the partnership; or

such foreign partnership is engaged in the conduct of a United States trade or business.

You generally may obtain a refund of any amounts withheld under the U.S. backup withholding rules that exceed your income tax liability by filing a refund claim with the United States Internal Revenue Service.

United States Alien Holders

If you are a United States alien holder, you are generally exempt from backup withholding and information reporting requirements with respect to:

dividend payments; and

the payment of the proceeds from the sale of preferred stock effected at a United States office of a broker; as long as the income associated with such payments is otherwise exempt from United States federal income tax, and:

the payor or broker does not have actual knowledge or reason to know that you are a United States person and you have furnished to the payor or broker:

a valid Internal Revenue Service Form W-8BEN or an acceptable substitute form upon which you certify, under penalties of perjury, that you (or, in the case of a United States alien holder that is a partnership or an estate or trust, such forms certifying that each partner in the partnership or beneficiary of the estate or trust is) are not a United States person; or

other documentation upon which it may rely to treat the payments as made to a non-United States person that is, for United States federal income tax purposes, the beneficial owner of the payments in accordance with U.S. Treasury regulations; or

you otherwise establish an exemption.

Payment of the proceeds from the sale of preferred stock effected at a foreign office of a broker generally will not be subject to information reporting or backup withholding.

However, a sale of preferred stock that is effected at a foreign office of a broker will be subject to information reporting and backup withholding if:

the proceeds are transferred to an account maintained by you in the United States;

the payment of proceeds or the confirmation of the sale is mailed to you at a United States address; or

the sale has some other specified connection with the United States as provided in U.S. Treasury regulations; unless the broker does not have actual knowledge or reason to know that you are a United States person and the documentation requirements

described above are met or you
otherwise establish an exemption.

In addition, a sale of preferred stock
will be subject to information
reporting if it is effected at a foreign
office of a broker that is:

a United States person;

a controlled foreign corporation
for United States tax purposes;

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a foreign person 50% or more of whose gross income is effectively connected with the conduct of a United States trade or business for a specified three-year period; or

a foreign partnership, if at any time during its tax year:

one or more of its partners are U.S. persons, as defined in U.S. Treasury regulations, who in the aggregate hold more than 50% of the income or capital interest in the partnership; or

such foreign partnership is engaged in the conduct of a United States trade or business;

unless the broker does not have actual knowledge or reason to know that you are a United States person and the documentation requirements described above are met or you otherwise establish an exemption.

Backup withholding will apply if the sale is subject to information reporting and the broker has actual knowledge that you are a United States person that is, for United States federal income tax purposes, the beneficial owner of the payments.

You generally may obtain a refund of any amounts withheld under the backup withholding rules that exceed your income tax liability by filing a refund claim with the Internal Revenue Service.

Taxation of Capital Securities

The following discussion of the material U.S. federal income tax consequences to the purchase, ownership and disposition of capital securities only addresses the tax consequences to a U.S. holder that acquires capital securities on their

original issue date at their original offering price and holds the capital securities as a capital asset for tax purposes. You are a U.S. holder if you are a beneficial owner of a capital security that is:

a citizen or resident of the United States;

a domestic corporation;

an estate whose income is subject to U.S. federal income tax regardless of its source; or

a trust if a U.S. court can exercise primary supervision over the trust's administration and one or more U.S. persons have authority to control all substantial decisions of the trust. This summary does not apply if the subordinated debt securities or capital securities:

are issued with more than a de minimis amount of original issue discount;

mature 1 year or less than or more than 30 years after the issue date;

are denominated or pay principal, premium, if any, or interest in a currency other than U.S. dollars;

pay principal, premium, if any, or interest based on an index or indices;

allow for deferral of interest for more than 5 years' worth of consecutive interest periods;

are issued in bearer form;

contain any obligation or right of us or a holder to convert or exchange the subordinated debt securities into other securities or properties of Zions;

contain any obligation or right of Zions to redeem, purchase or repay the subordinated debt securities (other than a redemption of the outstanding subordinated debt securities at a price equal to (1) 100% of the principal amount of the subordinated debt securities being redeemed, plus (2) accrued but unpaid interest, plus, if applicable, (3) a premium or make-whole amount determined by a quotation agent, equal to the sum of the present value of scheduled payments of principal and interest from the issue date of the subordinated debt securities to their redemption date, discounted at a rate equal to a U.S. treasury rate plus some fixed amount or amounts); or

contain any other material provision described only in the prospectus supplement.

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The material U.S. federal income tax consequences of the purchase, ownership and disposition of capital securities in a trust owning the underlying subordinated debt securities that contain these terms will be described in the applicable prospectus supplement.

The statements of law or legal conclusion set forth in this discussion constitute the opinion of Sullivan & Cromwell LLP, special tax counsel to us and each Issuer Trust. This summary is based upon the U.S. Internal Revenue Code of 1986, as amended, its legislative history, existing and proposed regulations under the Internal Revenue Code, published rulings and court decisions, all as currently in effect. These laws are subject to change, possibly on a retroactive basis. The authorities on which this discussion is based are subject to various interpretations, and it is therefore possible that the federal income tax treatment of the purchase, ownership and disposition of capital securities may differ from the treatment described below.

Please consult your own tax advisor concerning the consequences of owning the capital securities in your particular circumstances under the Internal Revenue Code and the laws of any other taxing jurisdiction.

Classification of the Issuer Trusts

Under current law and assuming full compliance with the terms of an amended trust agreement substantially in the form attached to this prospectus as an exhibit and the indenture, each Issuer Trust will not be taxable as a corporation for U.S. federal income tax purposes. As a result, you will be required to include in your gross income your proportional share of the interest income, including original issue discount, paid or accrued on the subordinated debt securities, whether or not the trust actually distributes cash to you.

***Interest Income and Original Issue
Discount***

Under Treasury regulations, an issuer and the Internal Revenue Service will ignore a remote contingency that stated interest will not be timely paid when determining whether a subordinated debt security is issued with original issue discount. On the date of this prospectus, we currently believe that the likelihood of exercising our option to defer interest payments is remote because we would be prohibited from making certain distributions on our capital stock and payments on our indebtedness if we exercise that option. Accordingly, we currently believe that the subordinated debt securities will not be considered to be issued with original issue discount at the time of their original issuance. However, if our belief changes on the date any capital security is issued, we will describe the relevant U.S. federal income tax consequences in the applicable prospectus supplement.

Under these regulations, if we were to exercise our option to defer any payment of interest, the subordinated debt securities would at that time be treated as issued with original issue discount, and all stated interest on the subordinated debt securities would thereafter be treated as original issue discount as long as the subordinated debt securities remained outstanding. In that event, all of your taxable interest income on the subordinated debt securities would be accounted for as original issue discount on an economic accrual basis regardless of your method of tax accounting, and actual distributions of stated interest would not be reported as taxable income. Consequently, you would be required to include original issue discount in gross income even though we would not make any actual cash payments during an extension period.

These regulations have not been addressed in any rulings or other interpretations by the Internal Revenue Service, and it is possible

that the Internal Revenue Service could take a position contrary to the interpretation in this prospectus.

Because income on the capital securities will constitute interest or original issue discount, corporate U.S. holders of the capital securities will not be entitled to a dividends-received deduction for any income taken into account on the capital securities.

Moreover, because income on the capital securities will constitute interest or original issue discount, U.S. holders of the capital securities will not be entitled to the preferential tax rate (generally 15%) generally applicable to payments of dividends before January 1, 2009.

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In the rest of this discussion, we assume that unless and until we exercise our option to defer any payment of interest, the subordinated debt securities will not be treated as issued with original issue discount, and whenever we use the term interest, it also includes income in the form of original issue discount.

Distribution of Subordinated Debt Securities to Holders of Capital Securities Upon Liquidation of the Issuer Trusts.

If the applicable Issuer Trust distributes the subordinated debentures as described above under the caption Description of Capital Securities and Related Instruments Liquidation Distribution Upon Dissolution , you will receive directly your proportional share of the subordinated debt securities previously held indirectly through the trust. Under current law, you will not be taxed on the distribution and your holding period and aggregate tax basis in your subordinated debt securities will be equal to the holding period and aggregate tax basis you had in your capital securities before the distribution. If, however, the trust were to become taxed on the income received or accrued on the subordinated debt securities due to a tax event, the trust might be taxed on a distribution of subordinated debt securities to you, and you might recognize gain or loss as if you had exchanged your capital securities for the subordinated debt securities you received upon the liquidation of the trust. You will include interest in income in respect of subordinated debt securities received from the trust in the manner described above under Taxation of Debt Securities Interest Income and Original Issue Discount .

Sale or Redemption of Capital Securities

If you sell your capital securities, including through a redemption for cash, you will recognize gain or loss equal to the difference between your adjusted tax basis in your capital securities and the amount you realize on the sale of your capital securities. Assuming that we do not exercise our option to defer payment of interest on the subordinated debt securities, your adjusted tax basis in your capital securities generally will be the price you paid for your capital securities.

If the subordinated debt securities are deemed to be issued with original issue discount as a result of an actual deferral of interest payments, your adjusted tax basis in your capital securities generally will be the price you paid for your capital securities, increased by original issue discount previously includible in your gross income to the date of disposition and decreased by distributions or other payments you received on your capital securities since and including the date of the first extension period. This gain or loss generally will be capital gain or loss, except to the extent any amount that you realize is treated as a payment of accrued interest on your proportional share of the subordinated debt securities required to be included in income. Capital gain of a non-corporate United States holder that is recognized before January 1, 2009 is generally taxed at a maximum rate of 15% where the holder has a holding period greater than one year.

If we exercise our option to defer any payment of interest on the subordinated debt securities, our capital securities may trade at a price that does not accurately reflect the value of accrued but unpaid interest with respect to the underlying subordinated debt securities. If you sell your capital securities before the record date for the payment of distributions, you will not receive payment of a distribution for the period before the sale. However, you will be required to include accrued but unpaid interest on the subordinated debt

securities through the date of the sale as ordinary income for U.S. federal income tax purposes and to add the amount of accrued but unpaid interest to your tax basis in the capital securities. Your increased tax basis in the capital securities will increase the amount of any capital loss that you may have otherwise realized on the sale.

In general, an individual taxpayer may offset only \$3,000 of capital losses against regular income during any year.

Backup Withholding Tax and Information Reporting.

We will be required to report the amount of interest income paid and original issue discount accrued on your capital securities to the Internal Revenue Service unless you are a corporation or other exempt U.S. holder. Backup withholding will apply to payments of interest to you unless you are an exempt U.S. holder or you

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furnish your taxpayer identification number in the manner prescribed in applicable regulations, certify that such number is correct, certify as to no loss of exemption from backup withholding and meet certain other conditions.

Payment of the proceeds from the disposition of capital securities to or through the U.S. office of a broker is subject to information reporting and backup withholding unless you establish an exemption from information reporting and backup withholding.

Any amounts withheld from you under the backup withholding rules will be allowed as a refund or a credit against your U.S. federal income tax liability, provided the required information is furnished to the Internal Revenue Service.

It is anticipated that each Issuer Trust or its paying agent will report income on the capital securities to the Internal Revenue Service and to you on Form 1099 by January 31 following each calendar year.

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PLAN OF DISTRIBUTION

Please note that in this section entitled Plan of Distribution, references to Zions, we, our and us refer only to Zions Bancorporation and not to its consolidated subsidiaries.

Initial Offering and Sale of Securities

We or the Issuer Trusts, as applicable may offer and sell the securities from time to time as follows:

through agents;

to or through dealers or underwriters;

directly to other purchasers; or

through a combination of any of these methods of sale.

In addition, the securities may be issued as a dividend or distribution or in a subscription rights offering to existing holders of securities. In some cases, we may also repurchase securities and reoffer them to the public by one or more of the methods described above.

The securities we distribute by any of these methods may be sold to the public, in one or more transactions, either:

at a fixed price or prices, which may be changed;

at market prices prevailing at the time of sale;

at prices related to prevailing
market prices;

at prices determined by an
auction process; or

at negotiated prices.

We or the Issuer Trusts, as applicable may solicit offers to purchase securities directly from the public from time to time. We may also designate agents from time to time to solicit offers to purchase securities from the public on our behalf. The prospectus supplement relating to any particular offering of securities will name any agents designated to solicit offers, and will include information about any commissions we may pay the agents, in that offering. Agents may be deemed to be underwriters as that term is defined in the Securities Act.

From time to time, we or the Issuer Trusts may sell securities to one or more dealers as principals. The dealers, who may be deemed to be underwriters as that term is defined in the Securities Act, may then resell those securities to the public.

We or the Issuer Trusts may sell securities from time to time to one or more underwriters, who would purchase the securities as principal for resale to the public, either on a firm-commitment or best-efforts basis. If we or the Issuer Trusts sell securities to underwriters, we or the Issuer Trusts, as applicable will execute an underwriting agreement with them at the time of sale and will name them in the applicable prospectus supplement. In connection with those sales, underwriters may be deemed to have received compensation from us in the form of underwriting discounts or commissions and may also receive commissions from purchasers of the securities for whom they may act as agents. Underwriters may resell the securities to or through dealers, and those dealers may receive compensation in the form of discounts, concessions or

commissions from the underwriters
and/or commissions from
purchasers for whom they may act
as agents. The applicable prospectus
supplement will include information
about any underwriting
compensation we pay to
underwriters, and any discounts,
concessions or commissions
underwriters allow to participating
dealers, in connection with an
offering of securities.

If we offer securities in a
subscription rights offering to our
existing security holders, we may
enter into a standby underwriting
agreement with dealers, acting as
standby underwriters. We may pay
the standby

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underwriters a commitment fee for the securities they commit to purchase on a standby basis. Additionally, before the expiration date for the subscription rights, the standby underwriters may offer the securities, including securities they may acquire through the purchase and exercise of subscription rights, on a when-issued basis at prices set from time to time by them. After the expiration date, the standby underwriters may offer the securities, whether acquired under the standby underwriting agreement, on exercise of subscription rights or by purchase in the market, to the public at prices to be determined by them. Thus, standby underwriters may realize profits or losses independent of the underwriting discounts or commissions we may pay them. If we do not enter into a standby underwriting arrangement, we may retain a dealer-manager to manage a subscription rights offering for us. Any dealer-manager we retain may acquire securities by purchasing and exercising the subscription rights and resell the securities to the public at prices it determines. As a result, a dealer manager may realize profits or losses independent of any dealer-manager fee paid by us.

We or the Issuer Trusts, as applicable may authorize underwriters, dealers and agents to solicit from third parties offers to purchase securities under contracts providing for payment and delivery on future dates. The third parties with whom we may enter into contracts of this kind may include banks, insurance companies, pension funds, investment companies, educational and charitable institutions and others.

The applicable prospectus supplement will describe the material terms of these contracts, including any conditions to the purchasers obligations and will include information about any commissions we may pay for soliciting these contracts.

Underwriters, dealers, agents and other persons may be entitled, under agreements that they may enter into with us, to indemnification by us or the Issuer Trusts, as applicable against civil liabilities, including liabilities under the Securities Act.

Underwriters may engage in stabilizing and syndicate covering transactions in accordance with Rule 104 under the Exchange Act. Rule 104 permits stabilizing bids to purchase the securities being offered as long as the stabilizing bids do not exceed a specified maximum. Underwriters may over-allot the offered securities in connection with the offering, thus creating a short position in their account. Syndicate covering transactions involve purchases of the offered securities by underwriters in the open market after the distribution has been completed in order to cover syndicate short positions. Stabilizing and syndicate covering transactions may cause the price of the offered securities to be higher than it would otherwise be in the absence of these transactions. These transactions, if commenced, may be discontinued at any time.

The underwriters, dealers and agents, as well as their associates, may be customers of or lenders to, and may engage in transactions with and perform services for, Zions, its subsidiaries and the Issuer Trusts in the ordinary course of business. In addition, we expect to offer the securities to or through our affiliates, as underwriters, dealers or agents. Among our affiliates, Zions Direct, Inc. may offer the securities for sale in the United States. Our affiliates may also offer the securities in other markets through one or more selling agents, including one another.

In compliance with guidelines of the National Association of Securities Dealers, Inc., or NASD, the maximum commission or discount to be received by any NASD member or independent broker dealer may not exceed 8% of the aggregate principal amount of

the securities offered pursuant to this prospectus. It is anticipated that the maximum commission or discount to be received in any particular offering of securities will be significantly less than this amount.

Zions Direct, Inc. is an indirect wholly-owned subsidiary of Zions. Rule 2720 of the Conduct Rules of the NASD imposes certain requirements when a NASD member such as Zions Direct, Inc. distributes an affiliated company's securities. Zions Direct, Inc. has advised Zions that each particular offering of debt securities will comply with the applicable requirements of Rule 2720. In any offerings subject to Rule 2720, the underwriters will not confirm initial sales to accounts over which it exercises discretionary authority without the prior written approval of the customer.

Furthermore, offering of capital securities by each of the Issuer Trusts will be conducted in accordance with the requirements of NASD Rule 2810.

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**Market-Making Resales by
Affiliates**

This prospectus may be used by Zions Direct, Inc. in connection with offers and sales of the debt securities in market-making transactions. In a market-making transaction, Zions Direct, Inc. may resell a security it acquires from other holders, after the original offering and sale of the security.

Resales of this kind may occur in the open market or may be privately negotiated, at prices related to prevailing market prices at the time of resale or at negotiated prices. In these transactions, Zions Direct, Inc. may act as principal or agent, including as agent for the counterparty in a transaction in which Zions Direct, Inc. acts as principal or as agent for both counterparties in a transaction in which Zions Direct, Inc. does not act as principal. Zions Direct, Inc. may receive compensation in the form of discounts and commissions, including from both counterparties in some cases. Other affiliates of

Zions may also engage in transactions of this kind and may use this prospectus for this purpose. These other affiliates may include Roth Capital.

The aggregate initial offering price specified on the cover of this prospectus relates to the initial offering of the securities. This amount does not include securities sold in market-making transactions.

Zions does not expect to receive any proceeds from market-making transactions. Zions does not expect that Zions Direct, Inc. or any other affiliate that engages in these transactions will pay any proceeds from its market-making resales to Zions.

A market-making transaction will have a settlement date later than the original issue date of the security.

Information about the trade and settlement dates, as well as the purchase price, for a market-making

transaction will be provided to the purchaser in a separate confirmation of sale.

Unless you are informed in your confirmation of sale that your security is being purchased in its original offering and sale, you may assume that you are purchasing your security in a market-making transaction.

**Matters Relating to Initial
Offering and Market-Making
Resales**

Each series of securities will be a new issue, and there will be no established trading market for any security prior to its original issue date. We or the Issuer Trusts, if applicable may not choose to list any particular series of securities on a securities exchange or quotation system. We and the Issuer Trusts have been advised by Zions Direct, Inc. that it intends to make a market in the securities, and any underwriters to whom we or the Issuer Trusts sell securities for public offering may make a market in those securities. However, neither Zions Direct, Inc. nor any underwriter that makes a market is obligated to do so and any of them may stop doing so at any time without notice. No assurance can be given as to the liquidity or trading market for any of the securities.

Unless otherwise indicated in the applicable prospectus supplement or confirmation of sale, the purchase price of the securities will be required to be paid in immediately available funds in New York City.

In this prospectus, the terms this offering means the initial offering of the securities made in connection with their original issuance. This term does not refer to any subsequent resales of such securities in market-making transactions.

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**EMPLOYEE RETIREMENT
INCOME SECURITY ACT**

*This section is relevant to you if you
are the fiduciary of a pension plan
or another employee benefit plan
proposing to invest in the securities.*

A fiduciary of a pension,
profit-sharing or other employee
benefit plan subject to Title I of the
Employee Retirement Income
Security Act of 1974, as amended
(ERISA), should consider the
fiduciary standards of ERISA in the
context of the plan's particular
circumstances before authorizing an
investment in the securities. Among
other factors, the fiduciary should
consider whether the investment
would satisfy the prudence and
diversification requirements of
ERISA and would be consistent
with the documents and instruments
governing the plan.

Section 406 of ERISA and
Section 4975 of the Internal
Revenue Code of 1986, as amended
(the Code), prohibit an employee
benefit plan, as well as individual
retirement accounts, Keogh plans
and other pension and profit sharing
plans subject to Section 4975 of the
Code, from engaging in certain
transactions involving plan assets
with persons who are parties in
interest under ERISA or
disqualified persons under the Code
with respect to the plan. A violation
of these prohibited transaction rules
may result in excise tax or other
liabilities under ERISA and
Section 4975 of the Code for such
persons, unless exemptive relief is
available under an applicable
statutory or administrative
exemption. Therefore, a fiduciary of
an employee benefit plan should
also consider whether an investment
in the securities might constitute or
give rise to a prohibited transaction
under ERISA and the Code.
Employee benefit plans which are
governmental plans (as defined in
Section 3(32) of ERISA), certain
church plans (as defined in
Section 3(33) of ERISA), and

foreign plans (as described in Section 4(b)(4) of ERISA) generally are not subject to the requirements of ERISA or Section 4975 of the Code.

We and certain of our affiliates may each be considered a party in interest or disqualified person with respect to employee benefit plans. This could be the case, for example, if one of these companies is a service provider to a plan. Special caution should be exercised, therefore, before the securities are purchased in an employee benefit plan. In particular, the fiduciary of the plan should consider whether exemptive relief is available under an applicable administrative exemption. The Department of Labor has issued five prohibited transaction class exemptions that could apply to exempt the purchase, sale and holding of the securities from the prohibited transaction provisions of ERISA and the Code.

Those class exemptions are Prohibited Transaction Exemption 96-23 (for transactions determined by in-house asset managers), Prohibited Transaction Exemption 95-60 (for certain transactions involving insurance company general accounts), Prohibited Transaction Exemption 91-38 (for certain transactions involving bank investment funds), Prohibited Transaction Exemption 90-1 (for certain transactions involving insurance company separate accounts), and Prohibited Transaction Exemption 84-14 (for certain transactions determined by independent qualified professional asset managers).

Due to the complexity of these rules and the penalties that may be imposed upon persons involved in non-exempt prohibited transactions, it is particularly important that fiduciaries or other persons considering the purchase of the securities on behalf of or with plan assets of any employee benefit plan consult with their counsel regarding the consequences under ERISA and the Code of the acquisition of the capital securities and the availability of exemptive relief under Prohibited

Transaction Exemption 96-23,
95-60, 91-38, 90-1 or 84-14.

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**VALIDITY OF THE
SECURITIES**

Unless otherwise indicated in the applicable prospectus supplement, certain matters of Delaware law relating to the Issuer Trust and the capital securities will be passed upon for the Issuer Trust and for us by Richards, Layton & Finger, P.A., Wilmington, Delaware. The validity of the securities offered by this prospectus will be passed upon for us by Callister Nebeker & McCullough, a Professional Corporation, Salt Lake City, Utah, and for the agents and/or underwriters by Sullivan & Cromwell LLP, Los Angeles, California. Sullivan & Cromwell LLP will rely upon the opinion of Callister Nebeker & McCullough as to matters of Utah law and Callister Nebeker & McCullough will rely upon the opinion of Sullivan & Cromwell LLP as to matters of New York law. The opinions of Callister Nebeker & McCullough and Sullivan & Cromwell LLP will be conditioned upon, and subject to certain assumptions regarding, future action to be taken by Zions and its board of directors in connection with the issuance and sale of any particular series of securities, the specific terms of the securities and other matters which may affect the validity of securities but which cannot be ascertained on the date of such opinions. Sullivan & Cromwell LLP regularly performs legal services for Zions.

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EXPERTS

Ernst & Young LLP, independent registered public accounting firm, has audited our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2005 and management's assessment of the effectiveness of our internal control over financial reporting as of December 31, 2005, as set forth in their reports, which are incorporated in this prospectus by reference. Our consolidated financial statements and management's assessment are incorporated by reference in reliance on Ernst & Young LLP's reports given on their authority as experts in accounting and auditing.

The financial statements of Amegy Bancorporation, Inc. as of and for the year ended December 31, 2004, incorporated by reference in this prospectus have been so incorporated by reference in reliance on the report of PricewaterhouseCoopers LLP, independent registered public accounting firm, given on their authority as experts in accounting and auditing.

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ZIONS BANCORPORATION

500,000 Shares of Common Stock

Offered to stockholders solely in
connection with the

**DIVIDEND REINVESTMENT
AND**

STOCK PURCHASE PLAN

PROSPECTUS SUPPLEMENT

December 1, 2008