

2002 Annual Report Executive Summary

Kentucky Highlands Empowerment Zone

During the period ended December 31, 2002, the Kentucky Highlands Empowerment Zone (KHEZ) continued its aggressive implementation of the Strategic Plan as all the Benchmarks made progress. The majority of the Empowerment Zone grant award has been earmarked for job creation efforts, and in this area, the KHEZ continues to be judged a success. Total employment within the three KHEZ counties at December 31, 2002 (the latest figures available) had grown to 20,687, an increase of 5,346 jobs (+34.8%) since designation. The overall KHEZ unemployment rate at November 2002 stood at 6.3%, down 1.1% for the year, although up by more than one percent since June. By comparison, the U.S. unemployment rate at November 2002 stood at 5.7% while the Kentucky unemployment rate was 4.9%. In general, the KHEZ communities have withstood the national economic downturn relatively well as only one company, Foothills Apparel in Clinton County with 120 employees, announced a plant closing during the period. Without this NAFTA-related plant closing, the KHEZ unemployment rate would have been below the national average. As reported earlier, a reason for the growth in total employment in the KHEZ has been the population increase over the last decade. According to the 2000 U.S. Census, the population of the three KHEZ counties stood at 43,052, an increase of 4,494 residents or 11.7% during the 1990's. This compares to a growth rate of 9.7% for Kentucky during the same period and a decline in population in the Appalachian counties of the Commonwealth, of which the KHEZ is part.

During the year ending December 31, 2002, the Developmental Venture Fund (Benchmark 1) approved five new loans to KHEZ companies. Included in these investments was financing for Foothills Academy, Inc. a nonprofit home for boys opened in Clinton County. The project is the culmination of seven years of work by local residents to find an alternative to detention facilities for young people in the area who have been abused, neglected or come to the judicial system for a minor reason. Foothills Academy has already been rated as the top male juvenile facility in Kentucky. Also of significance during the period was the conversion of the sheltered workshop started by the Empowerment Zone, JCR Industries, Inc. from a non-profit to a for-profit corporation. The company was purchased by management and several local businesses. This will bring needed capital, skills and stability to the company and its employees. The new company, JCRI, Inc., employs more than 80 residents and received working capital financing from the Developmental Venture Fund. The remaining loans approved during the year were for expansions of three existing KHEZ businesses and the opening of a professional engineering office in Jackson County. In addition, the KHEZ sold back to the company the 10% equity interest it held in Stonewall Jackson Molding, Inc. at the cost of issuance. The two companies who were previously granted moratoriums on their loan payments resumed normal payments during the period. Only one loan was significantly behind in payments and this company is working with the KHEZ on a restructure plan. The company is also involved in a federal lawsuit which may be heading toward a settlement in their favor. A second loan, which went into default in 2001, saw the KHEZ secure a judgement and repossess the collateral during the reporting period. An auction was held on a portion of the repossessed equipment with the balance to be auctioned in the future.

Total employment at the companies which have received financing from the Developmental Venture Fund stood at 3,401 at December 31, 2002. This is an increase of 395 for the year to date. Most of this growth was at American Woodmark Corporation, Cagles-Keystone Foods, LLC and Foothills Academy. The total private investment leveraged by the Fund grew to approximately \$120,000,000 at period end. The performance of the Developmental Venture Fund loan portfolio has been excellent. A total of \$19,857,022 in loans has been approved, with an outstanding balance of \$11,245,999 at December 31, 2002. In addition, a total of \$5,413,219 in loan repayments beyond the \$11 million Benchmark capitalization has been relent and is in use in the Zone.

The other major lending initiative within the KHEZ involves small farmers. The Alternative Crop Fund (Benchmark 6) continues to be a valuable resource, closing ten new loans during the period in the amount of \$48,000. A total of 124 Alternative Crop Loans, representing an investment of \$441,187 in KHEZ funds and loan repayments have been made to date. During the period ended December 31, 2002, ten Production Loan Funds were made. This brings the total since designation to fifty-one. The amount invested with Zone farmers through this Benchmark is now \$635,355. Both of these programs are very popular and the Lead Entity, Kentucky Highlands Investment Corporation, has received tobacco settlement funds to expand the programs beyond the KHEZ.

On the county level, several Benchmarks were completed and others made notable progress during the year. In Clinton County, the Clinton County 21st Century Learning Center (Benchmark 10) held a grand opening on May 17, 2002. This \$4.1 million education center/public library makes available college level classes for the first time to Clinton County residents. Two area universities are partners in this effort. Other Clinton County accomplishments include completion of the county emergency services building (Benchmark 38) which includes a private AirVac service; the opening of Foothills Academy (Benchmark 31), a center for trouble youths; the opening of a new manufacturer (Holiday Mansion International) in the Clinton County Industrial Park (Benchmark 2); and the sale of an additional tract in the industrial park to CalTech, Inc., a calibration testing company. All amendments to the Strategic Plan approved during 2002 were for projects in Clinton County. Each of the seven approved changes were budget amendments.

In Jackson County, the Environmental Impact Statement (EIS) for the reservoir (Benchmark 19) was completed in September 2001 after four years of planning. The EIS recommends a 113-surface acre lake at the War Fork/Steer Fork site. This site involves only seven property owners and no relocation. The major task on which the community continues to work, securing a Section 404 permit from the U.S. Army Corps of Engineers, is finally proceeding forward. The geological tests on the dam site were completed in October 2002 and the bearing capacity was found to be suitable. However, an obstacle for the lake arose during the period when the cost estimates rose from \$13 million to approximately \$18 million. Funding options are being examined but this appears to be a major barrier. Several other Jackson County projects also made progress on implementation. The community center/theater (Benchmark 25), located within a new vocational school was completed, with the school opening for classes in January 2002. For the current school year, more than 200 students are attending classes at the school. The entrepreneur training program (Benchmark 9) and the city of McKee revitalization project (Benchmark 16) continued on course. The certified day care provider training project (Benchmark 41) is underway as part of a new day care/family care center that was completed in November 2002 in the Jackson County Industrial Park. This center was funded in part through a \$499,000 RBEG award. The Strategic Plan annual review process in 2001 added 12 new benchmarked projects in Jackson County, of which ten have already been completed. No Strategic Plan amendments were proposed for Jackson County during 2002.

In Wayne County, all benchmarks are complete. The swimming pool at the ASPIRE Center (Benchmark 26) opened in July 2002 and had a successful year. Additionally, the ASPIRE Center appears to have established a program to put it on more secure financial footing by leasing some office space and obtaining support from the local industrial development groups. All other projects under the benchmarks within Wayne County are finished. The county continues to make progress outside the Strategic Plan as a new wing on the hospital and a new water plant broke ground in Fall 2002.

Several issues facing the KHEZ were resolved during the reporting period. The USDA - Office of Inspector General review of several items in Clinton County is nearing final resolution. The USDA-OIG issued an audit on March 22, 2002 which included three findings. The findings were addressed with management decision reached on one and pending on the remaining two. In addition, Kentucky

Highlands Investment Corporation, as Lead Entity, worked with USDA, the Commonwealth of Kentucky and the local communities to amend the Kentucky Highlands Investment Corporation Conflict of Interest Policy during the period. The amendment allows residents and businesses in the KHEZ to take advantage all of the programs which Kentucky Highlands Investment Corporation has available. During the period, the KHEZ also finalized the process for electing at least 55% of the members of the local EZ board of directors. This two-step process will be undertaken in February and March 2003, with any newly-elected board members taking their positions effective April 1, 2003.

Through the period ended December 31, 2002, the KHEZ has invested \$34,450,309, or 86.1%, of the SSBG award. Excluding the funds remaining for the reservoir in Jackson County (\$4,140,233), more than 96.4% of the KHEZ have already been expended in the communities. In addition to this amount, \$6,164,761 of loan payments has been relented within the Zone. This brings the total amount invested by the Kentucky Highlands Empowerment Zone in Clinton, Jackson and Wayne Counties to \$40,615,070. This is more than the \$40 million original award, validating the sustainability of the KHEZ Strategic Plan approach. The resulting impact is tangible and apparent.