

2003 Annual Report Executive Summary

Kentucky Highlands Empowerment Zone

During the period ended December 31, 2003, the Kentucky Highlands Empowerment Zone 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 November 30, 2003 (the latest figures available) had grown to an all-time high at 21,291, an increase of 5,944 jobs (+38.7%) since designation. The overall KHEZ unemployment rate at November 2003 stood at 5.5%, down 0.8% for the year. By comparison, the U.S. unemployment rate at November 2003 stood at 5.6% while the Kentucky unemployment rate was 5.2%. In general, the KHEZ communities have withstood the national economic downturn relatively well. Three companies, BMA Manufacturing, Inc., Fantasy Custom Yachts and Holiday Mansion Houseboats closed during the year. BMA Manufacturing, Inc. and Holiday Mansion Houseboats remain shuttered with a total loss of 30+ jobs. However, Fantasy Custom Yachts has been acquired by new investors and was reopened in December 2003. The company should return to an employment level of 100 persons in mid-2004.

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 ended December 31, 2003, the Developmental Venture Fund (Benchmark 1) approved nine new loans totaling \$983,000 to KHEZ companies. Included in these investments was further 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. The \$35,000 loan (bringing the total KHEZ loans to \$115,000) allowed Foothills Academy to receive a \$328,500 grant from the Federal Home Loan Bank of Cincinnati to construct a new cottage. Acting Undersecretary Gilbert Gonzalez also visited the home in August 2003 and announced a \$75,000 USDA Community Facilities grant to purchase equipment. Foothills Academy has already be rated as the top male juvenile facility in Kentucky and has grown to 40 employees.

Also of significance during the period was the announcement that the Appalachian Federal Credit Union (AFCU) will open its second branch, this one to serve KHEZ residents in Clinton and Wayne Counties. The first branch opened in July 1996 in Jackson County and has already made more than 2,100 loans for a total amount of approximately \$7 million. In order to establish the second branch, Kentucky Highlands Investment Corporation was able to secure a \$400,000 HUD Rural Housing & Economic Development grant for the project and the KHEZ committed \$200,000 in secondary market capital. The new office will open in March 2004.

Total employment at the companies which have received financing from the Developmental Venture Fund stood at 3,314 at December 31, 2003. This is a decrease of 67 for the year. With the closure three plants in the portfolio during the period, KHEZ feels this decrease is modest and should be reversed with the planned reopening of two houseboat plants. The total private investment leveraged by the Fund grew to more than \$120,000,000 at period end.

The performance of the Developmental Venture Fund loan portfolio has been excellent. A total of \$20,765,022 in loans has been approved, with an outstanding balance of \$10,507,729 at December 31, 2003. In addition, a total of \$6,396,219 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 nine new loans during the period in the amount of \$74,300. A total of 131 Alternative Crop Loans, representing an investment of \$475,007 in KHEZ funds and loan repayments have been made to date. During the period ended December 31, 2003, two new Production Loan Funds were made and several renewed. This brings the total since designation to fifty-eight. The amount invested with Zone farmers through this Benchmark is now \$724,175. Both of these programs are very popular.

On the county level, several more Benchmarks were completed and others continued to make progress during the year. In Clinton County, all Benchmark projects have been implemented or are very near completion. The centerpiece of the local efforts is the Clinton County 21st Century Learning Center (Benchmark 10). Opened in May 2002, this \$4.1 million education center/public library made available during 2003 more than fifty college level classes for the first time to Clinton County residents. Three area universities and the Kentucky vocational training program are partners in this effort. Other Clinton County accomplishments continued operation of the county emergency services building (Benchmark 38) which includes a private AirVac service; the expansion of Foothills Academy (Benchmark 31), a center for trouble youths; and, the opening of a new advanced calibration company (Caltech, Inc.) in the Clinton County Industrial Park (Benchmark 2).

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 is securing a Section 404 permit from the U.S. Army Corps of Engineers to impound water. This has been an unexpectedly slow process. Several other Jackson County projects also made progress on implementation. The community center/theater (Benchmark 25), located within a new vocational school was completed 2002. More than 200 students attend classes at the school and the theater has hosted numerous productions. The entrepreneur training program (Benchmark 9) continued on course. The day care/family care center (Benchmark 41) in the Jackson County Industrial Park was opened in 2003. Construction began on the McKee Downtown Revitalization project (Benchmark 16) with completion scheduled for mid-2004.

In Wayne County, all benchmarks are complete. The swimming pool at the ASPIRE Center (Benchmark 26) opened in July 2002 and had a successful second year in 2003. Additionally, the ASPIRE Center implemented 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 on a new wing on the hospital and a new water plant. Both of these projects will be complete in 2004.

Several issues facing the KHEZ were resolved during the reporting period. The USDA - Office of Inspector General review of several items in Clinton County detailed several concerns. The USDA-OIG issued an audit on March 22, 2002 which included three findings. The findings were addressed with management decision reached on all three findings during 2003.

During the period, the KHEZ also held its first Board member elections to elect at least 55% of the members of the local EZ board of directors. This two-step process began in February with the newly-elected board members taking their positions effective April 1, 2003. More than 750 KHEZ residents voted in the three counties.

Through the period ended December 31, 2003, the KHEZ has invested \$35,001,520, or 87.5%, of the SSBG award. Excluding the funds remaining for the reservoir in Jackson County (\$4,015,124), more than 97.5% of the KHEZ funds have already been expended in the communities. In addition to this amount, \$6,571,226 of loan payments has been relent within the Zone. This brings the total amount invested by the Kentucky Highlands Empowerment Zone in Clinton, Jackson and Wayne Counties to \$41,572,746. 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.