FDIC State Profile

SPRING 2003

Kentucky

Kentucky's economic expansion in 2002 was modest but among the best in the nation.

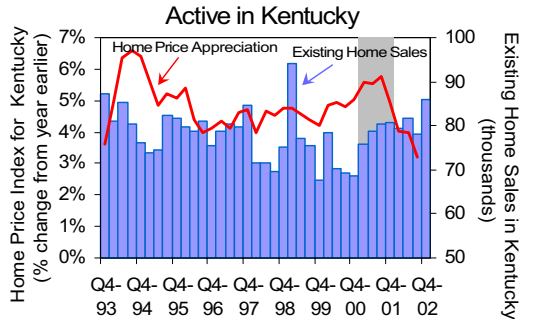
- Kentucky is one of five states that experienced employment growth in excess of 1 percent in 2002. Manufacturing job losses slowed considerably while employment growth in service-producing sectors strengthened and smaller changes occurred in other sectors (see **Table 1**).
- Over the past decade, Kentucky experienced job growth among producers of motor vehicles and parts, fabricated metal products, appliances, and other durable goods. Their expanding role helped soften the impact from shrinkage in such traditional sectors as tobacco, textiles, apparel, and coal mining. The establishment of a major UPS hub and growth in agricultural-related research and commercialization activity illustrate that Kentucky's economic transformation continues.
- Low mortgage rates and personal-income tax cuts helped sustain housing market activity in 2002 despite modest job growth. After rising rapidly in 2001, home resales posted a modest gain last year that was accompanied by a slowing in the pace of home price appreciation (see **Chart 1**).
- Although construction of new commercial properties is subdued, market conditions favor lessees over owners because large amounts of space are available for sublease. The industrial vacancy rate in the Cincinnati (OH-KY-IN) MSA is the highest in years but may have peaked at midyear 2002 (see **Chart 2**). Vacancy rates among Cincinnati's downtown and suburban office properties continued rising through fourth quarter 2002, when the 21 percent suburban vacancy rate was roughly double the rate from late 1996 through mid-2000. Other metropolitan areas likely are experiencing similar conditions.
- The Clarksville-Hopkinsville area is losing part of its resident population as military troops are deployed abroad. Fort Campbell, located there, pushes the share of the MSA's labor force employed by the military to over 25 percent, the fourth highest concentration in the nation.

Table 1: Kentucky's Labor Market Improved in 2002

	Change from 4 quarters earlier (thousands of jobs)	
	2001:Q4	2002:Q4
Payroll Employment	–13.3	21.6
Goods-Producing Sectors	–17.0	0.8
Mining	2.0	–0.4
Construction	1.3	2.7
Manufacturing	–20.3	–1.5
Durable Goods	–13.4	–2.0
Nondurable Goods	–6.9	0.5
Private Service-Producing Sectors	–0.2	15.1
Government	3.9	5.7

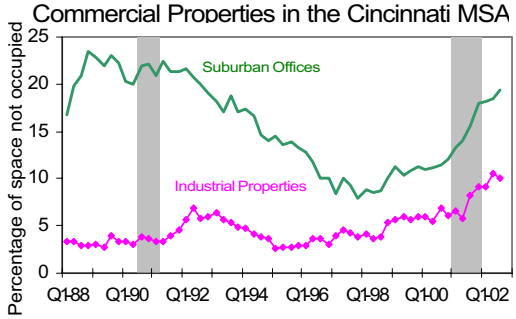
Source: Bureau of Labor Statistics

Chart 1: Single-Family Housing Market Remains Active in Kentucky



Sources: Office of Federal Housing Enterprise Oversight; National Association of Realtors

Chart 2: Vacancy Rates Are Climbing among Commercial Properties in the Cincinnati MSA

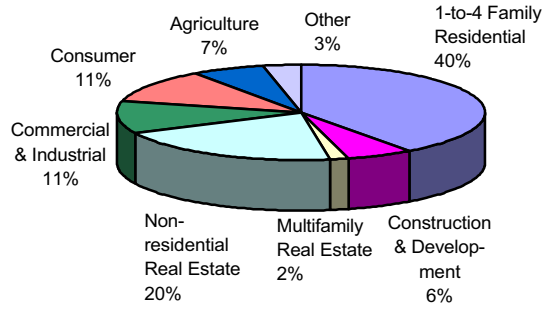


Source: CB Richard Ellis

Insured institutions headquartered in Kentucky weathered the recession fairly well.

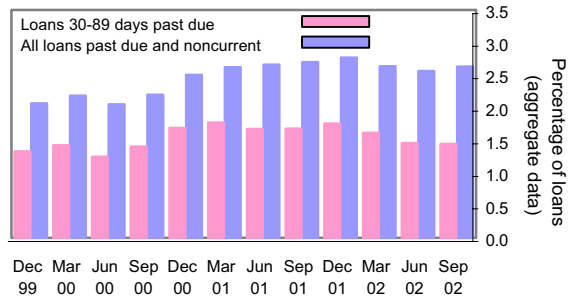
- Ninety-three percent of Kentucky's insured banks and thrifts are community institutions, that is non-de novo institutions with assets under $1 billion. Four percent are de novo institutions, less than three years old, and three percent have assets between $1 and $10 billion.
- In the aggregate, loan performance among institutions headquartered in Kentucky improved modestly in the year ending September 2002. However, median past-due and nonaccrual loans in September 2002 and 2001 remained 11 to 38 basis points higher than for the same reporting periods from 1997 through 2000 (see Page 3: Kentucky Banking At A Glance).
- Real estate dominates loan portfolios of community institutions headquartered in Kentucky: 1- to 4-family mortgages account for 40 percent of loan portfolios, nonresidential property and multifamily apartment loans total 22 percent, and construction-and-development loans are an additional six percent (see **Chart 3**).
- Community institutions as a group saw modest improvement in broad performance measures in the year ending September 30, 2002. The median return on assets (ROA) and net interest margin (NIM) increased, the median share of loans on past-due or nonaccrual status eased, and reserve coverage of loans rose.
- Moderation in the share of loans past due by 30 to 89 days at community institutions in recent quarters (see **Chart 4**) suggests that total past-due and nonaccrual loans may follow suit.
- While banks and thrifts generally weathered the recession fairly well, over six percent of community institutions were unprofitable on September 30, 2002, double the share two years earlier. Community institutions increased their allowance for loan losses relative to both total loans (1.25 percent median) and noncurrent loans (median multiple of 1.47) in the year ending September 30, 2002, while their median Tier 1 leverage ratio rose modestly to 9.38 percent.

Chart 3: Residential Mortgage Loans Dominate Portfolios at Kentucky's Community Institutions



Source: Bank and Thrift Call Reports

Chart 4: Dip in Loans 30-89 Days Past Due Suggests Total Past-Due & Nonaccrual Loans May Have Peaked



Source: Bank and Thrift Call Reports; data for established banks and thrifts with assets under $1 billion

Issues to Watch

- The state and national economies appear to be on track for continuing, moderate expansion, but the recovery is vulnerable to economic, financial, and geopolitical shocks that could arise at home or abroad. Lackluster growth nationwide would temper gains in the state's manufacturing and distribution industries.
- U.S. military deployment will heavily affect the Hopkinsville area. During the Gulf War, areas near major military bases experienced a drop in consumer spending, which curbed sales by local retailers, restaurants, and service providers. In some cases, housing markets weakened as military dependents left the area.
- Although having fared fairly well during the 2001 recession, banks and thrifts face weak loan demand, until economic growth strengthens noticeably. The past year's governance, fraud, and technology breaches (nationwide) highlight the need for monitoring internal controls and routines, internally at banks and thrifts as well as among their contractors and customers.

Kentucky at a Glance

General Information	Sep-02	Sep-01	Sep-00	Sep-99	Sep-98
Institutions (#)	248	260	279	290	307
Total Assets (in thousands)	55,251,187	56,771,411	53,491,699	54,363,578	54,387,033
New Institutions (# < 3 years)	11	15	17	18	21
New Institutions (# < 9 years)	39	41	41	38	38

Capital	Sep-02	Sep-01	Sep-00	Sep-99	Sep-98
Tier 1 Leverage (median)	9.29	9.47	9.72	9.50	9.58

Asset Quality	Sep-02	Sep-01	Sep-00	Sep-99	Sep-98
Past-Due and Nonaccrual (median %)	2.21%	2.31%	1.94%	1.93%	2.10%
Past-Due and Nonaccrual ≥ 5%	32	36	27	24	26
ALLL/Total Loans (median %)	1.26%	1.16%	1.16%	1.19%	1.21%
ALLL/Noncurrent Loans (median multiple)	1.59	1.41	1.65	1.83	1.79
Net Loan Losses/Loans (aggregate)	0.53%	0.45%	0.24%	0.35%	0.34%

Earnings	Sep-02	Sep-01	Sep-00	Sep-99	Sep-98
Unprofitable Institutions (#)	21	20	18	16	19
Percent Unprofitable	8.5%	7.7%	6.5%	5.5%	6.2%
Return on Assets (%, median)	1.11	1.03	1.19	1.19	1.26
25th percentile	0.72	0.57	0.78	0.80	0.89
Net Interest Margin (%,median)	4.06%	3.96%	4.25%	4.16%	4.30%
Yield on Earning Assets (median)	6.90%	8.16%	8.40%	7.95%	8.31%
Cost of Funding Earning Assets (median)	2.84%	4.19%	4.13%	3.78%	4.06%
Provisions to Avg. Assets (median)	0.19%	0.19%	0.16%	0.15%	0.14%
Noninterest Income to Avg. Assets (median)	0.67%	0.64%	0.60%	0.59%	0.61%
Overhead to Avg. Assets (median)	2.82%	2.87%	2.80%	2.77%	2.79%

Liquidity/Sensitivity	Sep-02	Sep-01	Sep-00	Sep-99	Sep-98
Loans to Deposits (median)	81.40%	82.96%	86.50%	83.72%	80.97%
Loans to Assets (median)	67.04%	67.71%	69.39%	67.43%	66.10%
Brokered Deposits (# of Institutions)	35	41	39	43	49
Bro. Deps./Assets (median for above inst.)	1.22%	0.76%	1.54%	1.46%	1.31%
Noncore Funding to Assets (median)	19.63%	20.56%	20.34%	18.14%	16.50%
Core Funding to Assets (median)	68.14%	67.72%	67.92%	70.26%	70.90%

Bank Class	Sep-02	Sep-01	Sep-00	Sep-99	Sep-98
State Nonmember	163	166	181	185	193
National	51	52	55	59	66
State Member	8	11	9	9	8
S&L	10	10	11	11	14
Savings Bank	16	21	23	26	26
Mutually Insured	0	0	0	0	0

MSA Distribution	# of Inst.	Assets (thou.)	% Inst.	% Assets
No metropolitan statistical area (MSA)	177	22,306,441	71.4%	40.4%
Lexington KY	22	4,166,327	8.9%	7.5%
Louisville KY-IN	17	22,941,193	6.9%	41.5%
Cincinnati OH-KY-IN PMSA	15	3,101,036	6.0%	5.6%
Huntington-Ashland WV-KY-OH	9	1,332,284	3.6%	2.4%
Owensboro KY	3	550,700	1.2%	1.0%
Clarksville-Hopkinsville TN-KY	3	660,036	1.2%	1.2%
Evansville-Henderson IN-KY	2	193,170	0.8%	0.3%