

PUBLIC DISCLOSURE

December 7, 2009

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**Blue Grass Federal Savings & Loan Association
600 High Street
Paris, Kentucky 40361-1811
Docket #: 06361**

**Office of Thrift Supervision
Southeast Region
1475 Peachtree Street
Atlanta, Georgia 30309**

NOTE: This document is an evaluation of this institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation of the institution. This evaluation is not, nor should it be construed as, an assessment of the financial condition of this institution. The rating assigned to this institution does not represent an analysis, conclusion, or opinion of the federal financial supervisory agency concerning the safety and soundness of this financial institution.



Office of Thrift Supervision
Department of the Treasury

Southeast Region

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January 5, 2010

Board of Directors
Blue Grass Federal Savings & Loan Association
600 High Street
Paris, Kentucky 40361-1811

Members of the Board:

Enclosed is your institution's written Community Reinvestment Act (CRA) Performance Evaluation. The Office of Thrift Supervision (OTS) prepared the evaluation as of December 7, 2009. Pursuant to the provisions of the CRA and OTS regulations (12 C.F.R. 563e), your institution must make this evaluation and your institution's CRA rating available to the public.

In accordance with 12 C.F.R. 563e, your institution must make this written CRA Performance Evaluation available to the public within 30 business days of receiving it. You must place the evaluation in your CRA public file at your home office and at each branch within this time frame. You may not alter or abridge the evaluation in any manner. At your discretion, you may retain previous written CRA Performance Evaluation(s) with the most recent evaluation in your CRA public file.

Your institution may prepare a response to the evaluation. You may place the response in each CRA public file along with the evaluation. In the event your institution elects to prepare such a response, please forward a copy of it to this office.

All appropriate personnel, particularly customer contact personnel, need to be aware of the responsibilities that the institution has to make this evaluation available to the public. Consequently, we suggest that your institution review internal procedures for handling CRA inquiries, including those pertaining to the evaluation and other contents of the CRA public file.

We strongly encourage the Board of Directors, senior management, and other appropriate personnel to review this document and to take an active interest and role in the CRA activities of your institution.

Sincerely,

Valorie Owen
Compliance Review Examiner V

Enclosure

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General Information

The Community Reinvestment Act (CRA) requires each federal financial supervisory agency to use its authority when examining financial institutions, to assess the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation of the institution. Upon conclusion of such examination, the agency must prepare a written evaluation of the institution's record of meeting the credit needs of its community.

This document is an evaluation of the CRA performance of Blue Grass Federal Savings & Loan Association (Blue Grass or Institution). The Office of Thrift Supervision (OTS) prepared the evaluation as of December 7, 2009. OTS evaluates performance in assessment area(s) delineated by the institution rather than individual branches. This assessment area evaluation may include visits to some, but not necessarily all, of the institution's branches. OTS rates the CRA performance of an institution consistent with the provisions set forth in Appendix A to 12 C.F.R. Part 563e.

Institution

Overall Rating

INSTITUTION'S CRA RATING: Blue Grass is rated “Satisfactory record of meeting community credit needs”.

At the preceding evaluation, conducted as of December 14, 2004, Blue Grass was assigned a CRA rating of “Satisfactory record of meeting community credit needs”. The Institution’s performance is again based upon the “streamlined” standards for small savings associations.

During the current review period, Blue Grass maintained a strong loan-to-deposit (LTD) ratio that averaged 122.4 percent, which was higher than that of similarly sized savings associations within the OTS’s Southeast Region.

Other measures of lending activity indicated that the Institution originated a reasonable volume of loan products, based upon its average asset size and in comparison to similarly sized OTS-regulated institutions. The Institution is a community savings association and offers a limited variety of lending products, including residential mortgage, nonresidential real estate mortgage, and loans secured by its own savings products.

The majority of the 1-4 family residential loan origination activity (71.3 percent) was secured by properties located within the assessment area. The Institution’s overall record of lending to low- and moderate-income (LMI) borrowers within the assessment area is considered strong compared to area demographics and to the record of similar mortgage lenders within the assessment area, especially when taking the percentage of low-income families below the poverty level into consideration. The Institution’s record of lending within the moderate-income census tracts (CTs) within the assessment area is considered reasonable compared to area demographics and to the lending record of similar mortgage lenders within the assessment area.

Institution (continued)

Scope of Examination

The time period reviewed for this evaluation will be from January 1, 2006, through December 31, 2008, since the 2004 and 2005 data is considered too old to be meaningful. Products reviewed included purchase and refinance mortgage loans originated during this period.

Description of Institution

Blue Grass is a federally-chartered, mutual savings association with total assets of approximately \$39.5 million as of September 30, 2009, and is located in Paris, Bourbon County, Kentucky, near the downtown business district. The Institution operates one office which is located in a middle-income CT. No branches were opened or closed during the review period. In addition, there are eight employees, all full-time.

The lobby is open for business from 9:00 a.m. to 5:00 p.m. Monday through Thursday and until 6:00 p.m. on Friday. The drive-in windows are open for business from 8:30 a.m. to 5:30 p.m. Monday through Thursday and until 6:00 p.m. on Friday. There are no Saturday hours. The hours of operation are adequate and consistent with those of the Institution's competitors.

Blue Grass operates an Automated Teller Machine (ATM) at its office, but deposits are not accepted. The Institution issues ATM cards that permit its customers to access their accounts through other institutions' ATM network systems including the PULSE, CIRRUS, and MasterCard networks.

As a traditional savings association, the Institution has concentrated its operations in the origination of mortgage loans and the acceptance of deposits. Blue Grass primarily engages in the origination of residential real estate loans. As of September 30, 2009, 83.4 percent of the Institution's total assets consisted of mortgage loans secured by permanent mortgages on single-family residences, multi-family dwellings, nonresidential property, home improvements, and mortgage-backed securities. In addition, 4.4 percent of total assets are invested in non-mortgage loans and 5.9 percent are invested in securities.

Blue Grass offers conventional fixed first mortgages for the purchase, refinance, home improvement, and construction of single-family residences, as well as non-residential mortgages. Loans secured by customer deposits and balloon mortgages are also available. The Institution retains all of its mortgage loan production in its own portfolio.

Institution (continued)

Description of Assessment Area

Blue Grass’ assessment area consists of all of Bourbon County, Kentucky. The area is located in central Kentucky, approximately 17 miles northwest of Lexington, Kentucky, and is part of the Lexington Metropolitan Statistical Area (MSA). According to the 2000 Census, the assessment area is comprised of six CTs with income designations, three moderate-income and three middle-income.

A moderate-income CT is one with a median family income (MFI) of at least 50.0 percent, and less than 80.0 percent of the MFI of a non-metropolitan area of a state or an MSA, and a middle-income CT is one with a MFI of at least 80.0 percent, and less than 120.0 percent, of the MFI of a non-metropolitan area of a state or an MSA.

The 2000 Census data will be used for an analysis of Blue Grass’ 2006, 2007, and 2008 mortgage lending activity.

The assessment area’s economy appears to be diversified and not too heavily dependent upon any one industry or employer. However, the equestrian industry heavily influences the area through the breeding and boarding of horses. Some of the area’s largest employers are Toyota Manufacturing, Malinckrodt (chemical manufacturing), CMWA (automobile parts manufacturing), Monessen Hearth (fireplace inserts), ITW Ramset (metal fabrication), Sekri Industries (textile manufacturing), Prime Finish (plastic coatings), and WalMart. In addition, there are numerous service industry businesses as well as federal, state, municipal, educational, and medical systems throughout the assessment area.

A summary of certain demographic characteristics for the assessment area based upon 2000 Census data is as follows:

| DEMOGRAPHICS OF CTs | | | FAMILY DISTRIBUTION | |
|---------------------|---------------|------------------------------|---------------------|--------------------------|
| CT Category | Population | Owner Occupied Housing Units | Income Category | Distribution of Families |
| Low | -0- | 0.0% | Low | 28.1% |
| Moderate | 9,994 | 51.6% | Moderate | 20.6% |
| Middle | 9,366 | 48.4% | Middle | 21.9% |
| Upper | -0- | 0.0% | Upper | 29.4% |
| Total | 19,360 | 100.0% | Total | 100.0% |

Institution (continued)

The examiner's review of 2000 Census data disclosed the following additional information about the assessment area:

| | |
|----------------------------------|----------------|
| Total Population | 19,360 |
| Population 16 and older | 15,011 (77.5%) |
| Population Over 65 | 2,631 (13.6%) |
| Total Housing Units | 8,349 |
| Owner-Occupied Housing Units | 5,032 (60.3) |
| Rental Occupied Units | 2,649 (31.7%) |
| 1 - 4 Family Units | 7,936 (95.1%) |
| Multi-Family Units | 413 (4.9%) |
| Total Families | 5,502 |
| Families Below the Poverty Level | 679 (12.3%) |

In addition, the Institution encounters substantial competition from many other financial institutions within the assessment area. Specifically, as of June 30, 2009, the latest information available, a total of four commercial banks and one savings association, Blue Grass, maintained a total of eight offices within the assessment area. Other institutions operating within the assessment area include Kentucky Bank, Traditional Bank, Inc., Fifth Third Bank, and Farmers National Bank. As of June 30, 2009, all institutions held approximately \$296.9 million in deposits within the assessment area. Blue Grass held approximately 9.2 percent of the assessment area's total deposits.

Given Blue Grass' resources, the examiner concludes that the assessment area is consistent with regulatory requirements.

Conclusions with Respect to Performance Tests

Loan-to-Deposit Ratio

Information compiled from the OTS's Thrift Financial Reports disclosed that Blue Grass' LTD ratio averaged 122.4 percent over the review period. This ratio is higher than the average LTD ratio of 81.7 percent during this period for similarly sized savings associations within the Southeast Region of the OTS.

The examiner concludes that the Institution's LTD ratio exceeds the standard for satisfactory performance for this criterion.

Institution (continued)

Lending within the Assessment Area

Due to its asset size, Blue Grass was not subject to the Home Mortgage Disclosure Act (HMDA) for the review period but did maintain a loan/application register that captured data similar to that required by the HMDA. After reviewing these records, the examiner determined that the Institution originated 80 mortgage loans between January 1, 2006, and December 31, 2008. The examiner also determined that the majority of the originated mortgage loans were secured by property located within the assessment area as described below:

| LOAN APPROVALS/ORIGINATIONS DURING THE REVIEW PERIOD | | | | |
|---|---------------|-----------------|----------------------|-------------------|
| Approvals/Originations | Number | Pct. No. | Volume (000s) | Pct. Of \$ |
| Inside Assessment Area | 57 | 71.3% | \$4,603 | 60.4% |
| Outside Assessment Area | <u>23</u> | <u>28.7%</u> | <u>3,013</u> | <u>39.6%</u> |
| Total | 80 | 100.0% | \$7,616 | 100.0% |

Based upon the data referenced above, the examiner concludes that Blue Grass' level of mortgage lending within the assessment area meets the standard for satisfactory performance for this particular criterion.

Lending to Borrowers of Different Income Levels

In order to evaluate Blue Grass' record of lending to borrowers of different income levels for 2006 through 2008, family income levels were stratified as a percentage of the updated MFI for the Lexington MSA. The updated MFI figures, as provided by the Department of Housing and Urban Development, for the Lexington MSA for 2006, 2007, and 2008 were \$61,800, \$59,800, and \$63,500, respectively.

Institution (continued)

From information contained in the Institution’s records, the examiner compiled the following borrower income distribution statistics:

| Income Category | Percent Of MFI | Number | No. Pct. | Volume (\$000s) | Pct. of \$ | Distribution Of Families |
|------------------------|-----------------------|---------------|-----------------|------------------------|-------------------|---------------------------------|
| Low | <50% | 8 | 26.7% | 235 | 8.8% | 28.1% |
| Moderate | ≥50-<80% | 8 | 26.7% | 701 | 26.2% | 20.6% |
| Middle | ≥80-<120% | 7 | 23.3% | 601 | 22.4% | 21.9% |
| Upper | ≥120% | <u>7</u> | <u>23.3%</u> | <u>1,141</u> | <u>42.6%</u> | <u>29.4%</u> |
| Total | | 30* | 100.0% | \$2,678 | 100.0% | 100.0% |

*Applicant income was not available for 27 originations totaling approximately \$1,925,000.

As indicated above, the percentage of mortgage loans granted to low-income borrowers was generally commensurate with the percentage of low-income families within the assessment area. Blue Grass’ ability to originate mortgage loans to low-income borrowers is likely influenced by the family poverty levels within the assessment area. The examiner noted that according to the 2000 Census, approximately 43.8 percent of the low-income families residing within the assessment area have incomes below the poverty level (12.3 percent of all families living within the assessment area have incomes below the poverty level). The Institution’s level of mortgage lending to moderate-income borrowers was higher than the percentage of moderate-income families residing within the assessment area.

Blue Grass’ overall record of lending to borrowers of different income levels was also compared to the lending activity of other lenders subject to the CRA that originated HMDA reportable loans within the assessment area, focusing upon LMI borrowers. In accordance with the HMDA, creditors with total assets greater than \$250 million and a branch office located within an MSA, must submit certain information regarding mortgage loans for purchase, refinance, and home improvement purposes for all property locations. This information was derived from the 2006, 2007, and 2008 HMDA Aggregate information, the latest available.

Institution (continued)

Based upon the data shown below for 2006, 2007, and 2008, Blue Grass’ combined record of lending to LMI borrowers was higher than that of other lenders within the assessment area, as well as the assessment area’s LMI demographics.

2006/2007/2008 Aggregate HMDA Borrower Income Analysis for Mortgage Loan Originations of similar products by other lenders within the Assessment Area

| Income Category | Percent Of MFI | Blue Grass Percent of No. | Other Lenders Percent of No. | Distribution Of Families |
|------------------------|-----------------------|----------------------------------|-------------------------------------|---------------------------------|
| Low | <50% | 26.7% | 12.3% | 28.1% |
| Moderate | ≥50-<80% | 26.7% | 24.3% | 20.6% |

The examiner determined that Blue Grass’ overall level of lending to borrowers of different income levels exceeds the standard for satisfactory performance for this criterion, especially when accounting for the poverty levels within the assessment area.

Geographic Distribution of Loans

The examiner also performed a review to determine the adequacy of dispersion of lending with regard to lending within the moderate-income CTs of the assessment area for 2006, 2007, and 2008. Specifically, the examiner analyzed the percentage of residential mortgage loans, by number and dollar amount of the mortgage loans originated by Blue Grass within the LMI CTs compared to the percentage of owner-occupied housing units (OOHUs) located within those areas.

The analysis disclosed the following information concerning the Institution’s record of residential mortgage lending throughout the different CTs within the assessment area. The percentage of OOHUs is derived from the 2000 Census:

| Income Category | Percent of MFI | Number | No. Pct. | Volume (\$000s) | Pct. Of \$ | Distribution Of OOHUs |
|------------------------|-----------------------|---------------|-----------------|------------------------|-------------------|------------------------------|
| Moderate | ≥50-<80% | 25 | 47.2% | 2,306 | 52.1% | 51.6% |
| Middle | ≥80-<120% | 28 | 52.8% | 2,117 | 47.9% | 48.4% |
| Total | | 53* | 100.0% | \$4,423 | 100.0% | 100.0% |

*Geographic information was not available for four originations totaling approximately \$180,000.

Blue Grass’ overall level of lending within the moderate-income CTs within the assessment area was slightly less than the assessment area’s LMI demographics on a number basis, and generally commensurate on a dollar volume basis.

Institution (continued)

Blue Grass’ overall record of lending within the moderate-income CTs was also compared to the lending activity of other lenders subject to the CRA that maintained offices within the assessment area. This information was derived from the 2006, 2007, and 2008 HMDA Aggregate information, the latest available. In order to provide a more accurate comparison, the lending activity was compiled for all types of mortgage loans for single-family dwellings originated by lenders subject to the CRA, focusing upon mortgage lending within the moderate-income CTs.

Based upon this data for 2006, 2007, and 2008, Blue Grass’ level of lending within the moderate-income CTs was commensurate with that of other lenders, but slightly less than the assessment area’s demographics as indicated below:

2006/2007/2008 Aggregate HMDA Geographic Distribution Analysis for Mortgage Loan Originations of similar products by other lenders within the Assessment Area

| Income Category | Percent Of MFI | Blue Grass Percent of No. | Other Lenders Percent of No. | Distribution Of O.O.H.U. |
|------------------------|-----------------------|----------------------------------|-------------------------------------|---------------------------------|
| Moderate | ≥50-<80% | 47.2% | 47.4% | 51.6% |

Based upon the Institution’s overall level of lending within the moderate-income CTs, the examiner determined that Blue Grass’ overall geographic distribution of lending for the review period meets the standard for satisfactory performance for this criterion.

Fair Lending or Other Illegal Credit Practices Review

Record of Compliance with Anti-discrimination Laws and Regulations

A sample of loan application files was reviewed at the Institution’s most recent compliance examination to determine the Institution’s level of compliance with anti-discrimination laws and regulations, including the OTS Nondiscrimination Regulations; the Equal Credit Opportunity Act and its implementing regulation, Regulation B; and the Fair Housing Act. No violations of the substantive provisions of the laws and regulations prohibiting discrimination or other illegal credit practices were identified through the evaluation of compliance with consumer laws and regulations.

Response to Community Complaints

No complaints concerning Blue Grass’ performance in meeting the credit needs of the assessment area have been received since the preceding evaluation.

CRA Rating Definitions

There are four separate and distinct CRA assessment methods set forth in the CRA: the lending, investment, and service tests for large, retail institutions; the streamlined examination method for small institutions; the community development test for wholesale and limited purpose institutions; and the strategic plan option for all institutions. OTS will assign an institution one of the four assigned ratings required by Section 807 of the CRA:

1. "Outstanding record of meeting community credit needs."
2. "Satisfactory record of meeting community credit needs."
3. "Needs to improve record of meeting community credit needs."
4. "Substantial noncompliance in meeting community credit needs."

OTS judges an institution's performance under the test and standards in the rule in the context of information about the institution, its community, its competitors, and its peers. Among the factors to evaluate in an examination are the economic and demographic characteristics of the assessment area(s); the lending, investment, and service opportunities in the assessment area(s); the institution's product offerings and business strategy; the institution's capacity and constraints; the prior performance of the institution; in appropriate circumstances, the performance of a similarly situated institution; and other relevant information. An institution's performance need not fit each aspect of a particular rating profile in order to receive that rating, and exceptionally strong performance with respect to some aspects may compensate for weak performance in others. The institution's overall performance, however, must be consistent with safe and sound banking practices and generally with the appropriate rating profile. In addition, OTS adjusts the evaluation of an institution's performance under the applicable assessment method in accordance with §563e.21 and §563e.28, which provide for adjustments on the basis of evidence of discriminatory or other illegal credit practices.