

2018

ANNUAL REPORT



OUR VISION

To be a stable and sustainable development finance institution providing access to funds for the economic and social well-being of its members.

Table of Contents	Page
Transmittal Letter	2
Message from the President & CEO.....	3
I. Background & Corporate Information	5
Establishment	5
Bank's Vision	5
Bank's Mission & Purpose	5
Shareholders & Paid In Capital	5
Organizational Chart	6
Board of Governors	7
Board of Directors	8
II. 2018 Operational Summary	9
A. Loan Report	9
Approved Loans	9
Outstanding Loans by Sector	9
Loan Distribution by Shareholder	10
Loan Mix	10
Loan Delinquency	11
Loan Charge offs	11
B. Financial Report	12
Performance vs. Previous Year (2017).....	12
Asset Mix	13
Revenue by Source	13
Major Expenses	14
Financial Summary, 2005 – 2018	15
Selected Financial Ratios	18
III. Board Activities Report	19
Board of Governors	19
Board of Directors	19
IV. Financial Statements & Independent Auditors' Report	20

Transmittal Letter

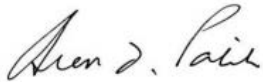
March 31, 2019

Board of Governors
Pacific Islands Development Bank

Dear Governors:

Pursuant to Section 12 of Article 13 of the *Articles of Agreement Establishing the Pacific Islands Development Bank*, and Section 7 of Article II of the Bank's *Bylaws*, it is my pleasure to transmit, on behalf of the Board of Directors, the Pacific Islands Development Bank's Annual Report for the period ended December 31, 2018.

Respectfully,



Aren B. Palik
President & CEO
Chairman, Board of Directors

Message from the President & CEO

From a regional perspective, 2018 was an eventful, historical, and memorable year. In November 2018, the Commonwealth of the Northern Mariana Islands was devastated by Super-typhoon Yutu, the strongest typhoon ever to hit CNMI with catastrophic destruction and damages to homes, businesses, and infrastructure. The lives and livelihood of CNMI residents were forever changed and its economy took a major setback. Doing its part, PIDB provided relief to its CNMI borrowers through loan payment deferment, loan restructure and refinance, and adjustments in loan payment for commercial clients whose cash flow was affected by the typhoon. We pray for our brothers and sisters in CNMI and hope for continued progress in its recovery efforts.

Throughout the region, elections were also held in November 2018 with new leadership in Guam, Yap, Kosrae, and Commonwealth of the Northern Mariana Islands. Many of the Bank's Board members were elected to prominent leadership positions. First ever female Governor Lourdes Leon Guerrero was elected Governor of Guam; Henry Falan was elected Governor of Yap State, Carson Sighra was elected Governor of Kosrae State, and Ralph Torres was re-elected Governor of CNMI. Additionally, PIDB Board member Tina Muna Barnes was elected Speaker of the 35th Guam Legislature, Vincent Figir was elected Speaker of the 10th Yap State Legislature, and Rolner Joe was elected Vice Speaker of the 12th Kosrae State Legislature. Given the ownership and corporate structure of PIDB, the political support of leaders throughout the region is crucial to the Bank. Congratulations to our Board members who won in the November 2018 elections.

The Yap State Business Development Loan Program administered by PIDB was fully implemented in 2018 with the entire \$3 million fully disbursed. The objective of this program is to promote private sector growth in Yap with emphasis in tourism, agriculture, and fisheries. We are now servicing and managing the program with intent to expand it through rei-investment and the multiplier effect. We thank the leadership of Yap State not only for selecting PIDB to administer the program, but also for its confidence and commitment to PIDB.

During the period under review, we gained more traction on the residential housing loan program in Kwajalein Atoll/Ebeye. Total investment under the housing program exceeded \$800,000 in 2018 with more loans expected in 2019. With prudent management of the portfolio, all loans funded under the program are current with zero loan delinquency at year end. I am also pleased to report that another \$500,000 has been approved with disbursement expected upon signing of a sub-grantee agreement between PIDB and the RMI government. The agreement provides for annual perpetual funding to expand the residential housing program in Kwajalein/Ebeye. We thank the leadership of Kwajalein Atoll Development Authority (KADA) and the RMI government for their commitment and unwavering support.

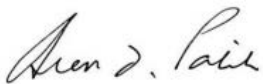
In 2018, Pacific Islands Development Bank was selected by the Guam Business Magazine as one of the top 35 Companies in Micronesia. The selection criteria include balance sheet strength and growth, earnings, management, and contributions to economic and social development of the islands/economies in the Micronesia sub-region. Congratulations PIDB!

From an operational standpoint, the Bank once again did very well in 2018. It was by far the best year yet with record performance set in the following key performance indicators:

- *Total Assets increased by 12.8% or \$1.9 million to \$17.4 million.*
- *Loans Receivable increased by 28.5% or \$3.4 million to \$15.3 million.*
- *Stockholders' Equity increased by 17.6% or \$2.1 million to \$14.5 million.*
- *Retained Earnings increased by 70.1% or \$2.1 million to \$5.2 million.*
- *Net Income increased by 92.2% or \$1.0 million to \$2.1 million.*
- *Record Return on Assets of 12.3% and Return on Equity of 14.8%.*
- *Achieved **unqualified** audit opinion with no questioned costs.*
- *Chuuk State made an equity payment of \$25,000, increasing its paid-in membership capital to \$276,783.*

As we close and celebrate the best year yet for the bank, we simply cannot rest on those past achievements. In today's rapidly changing political, economic, and technological environment, both from a global and regional perspective, operating without a Strategic Plan is synonymous with sailing in a vast ocean without a compass. As such, 2018 marked the fifth and final year of operation under its current Strategic Plan (2014-2018). Given the importance of strategic and corporate planning, the Bank revised its Plan for the next 3 years, 2019 to 2021. The planned period has been reduced from five years to three years, a practice that most development banks are now following. The key goals and objectives in the revised Plan are balance sheet growth, improved earnings, and capacity enhancement, especially in financial, human, and technical resources.

In closing, let me take this opportunity to thank our Shareholders, Board of Governors, and Board of Directors for their unwavering support and commitment. I would also like to convey our gratitude and appreciation to our staff for their diligence, dedication, and contributions.



Aren Palik
President & CEO

I. Background & Corporate Information

Establishment

Pacific Islands Development Bank was created on July 5, 1989 through a Resolution approved by the Association of Pacific Island Legislatures (APIL). Its corporate office is in Guam.

Bank's Vision

"To be a stable and sustainable development finance institution providing access to funds for the economic and social well-being of its members."

Bank's Mission & Purpose

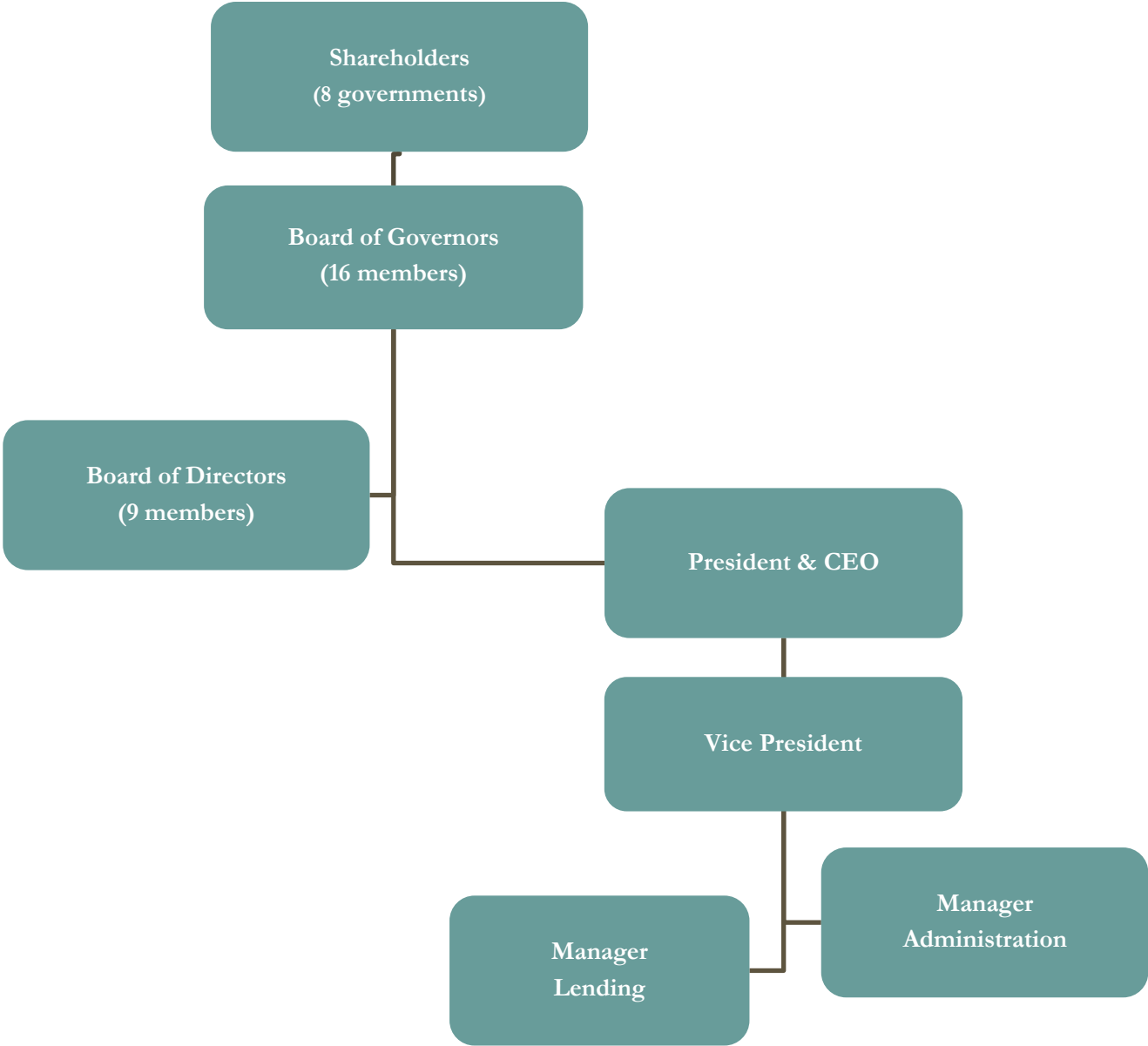
"To contribute to the acceleration of the process of economic and social development of member countries and States, individually and collectively, and to promote economic cooperation among them."

Shareholders & Paid in Capital

Shareholders	2018	
	# Shares	Value
Chuuk	276	276,783
CNMI	1,000	1,000,000
Guam	1,000	1,000,000
Kosrae	820	820,000
Marshall Is.	1,992	1,992,000
Palau	1,000	1,000,000
Pohnpei	1,300	1,300,000
Yap	1,439	1,438,866
Kwajalein Atoll	500	500,000
Total	9,327	\$9,327,649

The initial capital each member pledged and agreed to pay is \$1 million. For the period under review, Chuuk State made an additional capital payment of \$25,000 towards its equity shares in the bank. Management continues to work with individual country members for additional capital funding.

Organizational Chart



Board of Governors

The *Articles of Agreement Establishing the Pacific Islands Development Bank*, as amended, stipulates that each member shall appoint two Governors (one representing the Executive branch and the other representing the Legislative branch) to the Board of Governors. At its annual meeting, the Board elects new officers for the ensuing year. The members of the Board of Governors and its officers for the period under review are as follows:

Shareholder	Executive Branch Rep.	Legislative Branch Rep.
Chuuk:	Vacant	Vacant
CNMI:	Ralph DLG Torres Governor	Joseph Deleon Guerrero, Vice Chair Congressman
Guam:	Edward Calvo Governor	Vacant
Kosrae:	Carson Sigrah Lt. Governor	Tulensa Palik Speaker
Marshall Is.	Brenson Wase Minister of Finance	Kenneth Kedi, Secretary Speaker
Palau:	Elbuchel Sadang Minister of Finance	Swenny Ongidobel, Chairman Delegate, House of Delegates, OEK
Pohnpei:	Reed Oliver Lt. Governor	Carlos Villazon Budget Officer
Yap:	Tony Ganngiyan Governor	Stanislaus D. Kensof Senator

Board of Directors

The *Articles of Agreement Establishing the Pacific Islands Development Bank*, as amended, stipulates that the two Governors representing each member shall appoint one person to represent that member entity on the Board of Directors. The Board of Directors is authorized by the Board of Governors to exercise all powers of the Bank with the exception of those expressly reserved to the Board of Governors under the Agreement. The Board of Directors meets quarterly with the Bank President and CEO serving as Chairman pursuant to the Bank's *Articles*.

The following individuals served on the Board of Directors during the year under review:

Palau	CNMI	Guam
Elbuchel Sadang Minister of Finance Palau National Govt.	Diego Benavente Former Lt. Governor/ Former Speaker	Lourdes Leon Guerrero President & CEO Bank of Guam
Kosrae State	Pohnpei State	Yap State
Robson Henry Retired U.S. Army Veteran U.S. Military.	Christina Elnei Budget Officer Pohnpei State Govt.	John Masiwemai Senator/Chairman, R&D Committee Yap State Legislature
Chuuk State	Marshall Islands	Kwajalein Atoll Development Authority
Vacant	Alfred Alfred, Jr. Member of Parliament RMI Parliament (Nitijela)	Anjojo Kabua III Executive Director Kwajalein Atoll Development Authority
Management		
Aren Palik President/CEO Chairman		

II. 2018 Operational Summary

A. Loan Report

Approved Loans

Loan Type	2018 No. of Loans	Amount	2017 No. of Loans	Amount
Commercial Loans				
Agriculture	0	0	0	0
Fisheries	1	20,168	2	100,000
Tourism	5	3,418,587	4	9,000
Manufacturing	0	0	0	100,000
Services	3	409,000	3	1,010,699
Commercial	2	1,131,492	3	400,000
Sub Total	11	4,979,247	12	1,619,699
Residential Home Loans	11	1,190,679	5	523,109
Consumer Loans	45	409,412	21	794,325
Total	67	6,579,338	38	2,937,133

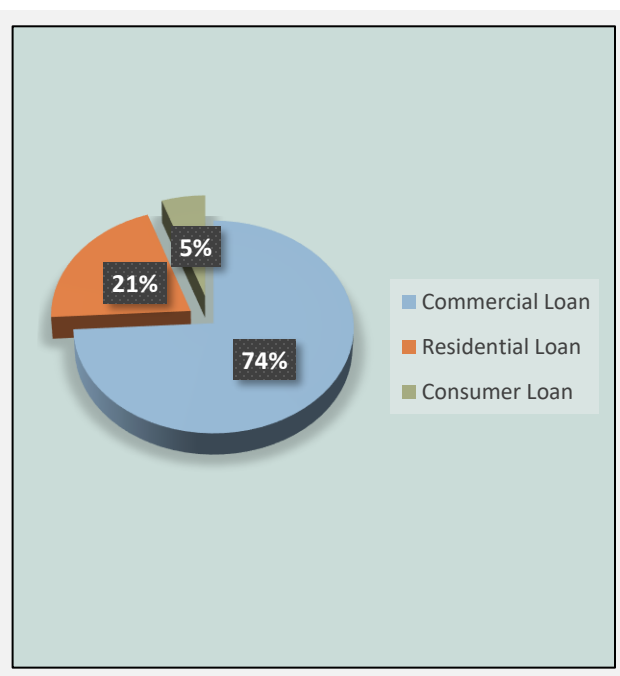
Outstanding Loans by Sector

Loan Type	2018 #	Amount \$	2017 #	Amount \$
Commercial Loans				
Agriculture	0	0	3	627,798
Fisheries	3	621,805	3	159,806
Tourism	15	3,399,644	12	935,006
Manufacturing	0	0	0	265,148
Services	25	2,855,450	42	2,802,532
Commercial	35	4,473,728	26	3,255,590
Sub Total	78	11,350,627	86	8,045,880
Residential Home Loans	46	3,164,653	37	2,873,559
Consumer Loans	135	806,663	163	1,000,070
Total	259	15,321,943	286	11,919,509

Loan Distribution by Shareholder

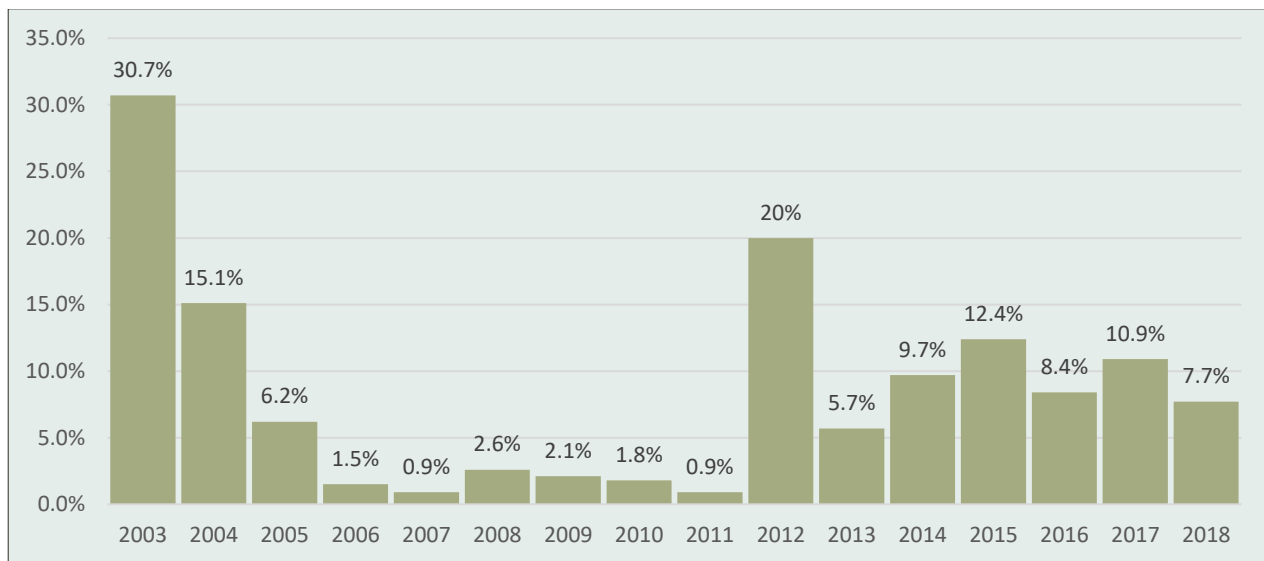
Shareholder	Commercial		Consumer		Housing		Total	
	#	Value	#	Value	#	Value	#	Value
Guam	11	910,420	37	237,190	8	428,308	56	1,575,918
Palau	5	753,068	5	33,404	1	72,571	11	859,043
Pohnpei	2	536,003	16	150,244	6	291,181	24	977,428
Yap	14	4,598,606	45	260,690	5	316,286	64	5,175,582
Kosrae	29	1,008,068	23	81,790	11	247,288	63	1,337,146
CNMI	3	1,099,065	6	24,810	5	351,098	14	1,474,973
Chuuk	1	28,445	0	0	0	0	1	28,445
RMI	13	2,416,952	3	18,535	5	813,621	21	3,249,108
KADA	0	0	0	0	5	644,300	5	644,300
Total	78	11,350,627	135	806,663	46	3,164,653	259	15,321,943

Loan Mix

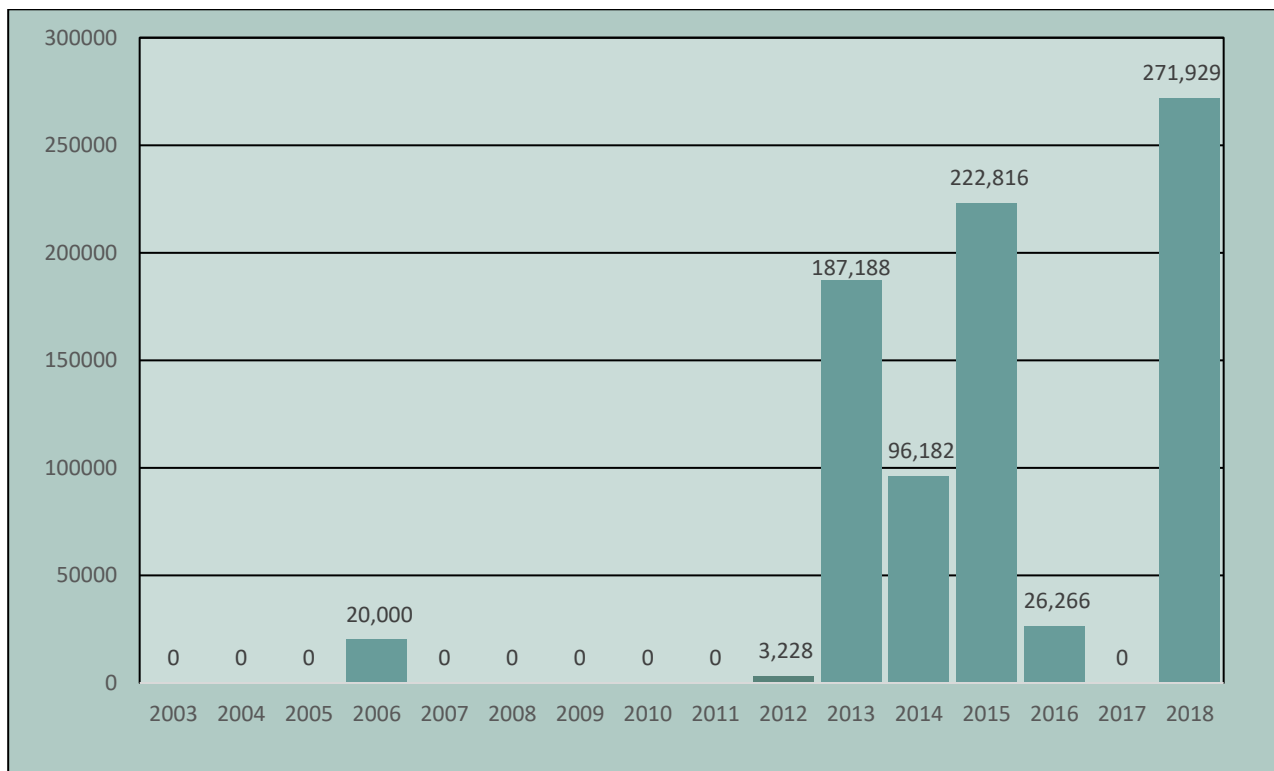


At 12/31/18, 74% or \$11.3 million of total loans was in Commercial Loans; 21% or \$3.1 million in Residential Home Loans; and 5.2% or \$806,663 in Consumer Loans. The Bank's core lending is in Commercial loans, consistent with its core mission and purpose. For the period under review, average Consumer Loan per borrower is \$5,975; average Residential Home Loans is \$68,796; and average Commercial loan per borrower is \$145,520.

Loan Delinquency



Loan Charge Off



B. Financial Report

Performance Against Previous Year (2017)

For the period under review, Loans Receivable increased significantly by about 29% to \$15.3 million. In 2018, there was an increase in Commercial and Residential loans which are contributing factors to the increase in loans receivable in the period under review. Stockholders' Equity grew by 17.6% or \$2.1 million to \$14.5 million due primarily to improvement in the Bank's Retained Earnings and additional equity capital infusion from Pohnpei State, Chuuk State and initial payment from Kwajalein Atoll Development Authority. Total Assets also saw a significant increase of 12.8% or \$1.9 million to \$17.4 million attributed to additional capital infusion of \$2,250,000 by Yap State Government to fund the business development program. Retained Earnings grew by 70.1% to \$5.2 million attributed to a net income of \$2,153,927 for the year. Gross Revenue increased by \$1.6M or 94% due mainly to the contribution from Yap State. Total Operating Expenses increased by \$157,769 or 33.3% as a result of enhanced collection efforts by management in the islands and the increased rent of the new office. Netting expenses from revenue, the Bank realized a Net Income of \$2,153,927 which is significantly higher than the previous year. This is attributed to the \$2,250,000 received from Yap State which was booked as a restricted contribution. The Table below compares the bank's performance in 2018 against the previous year (2017) in selected key areas.

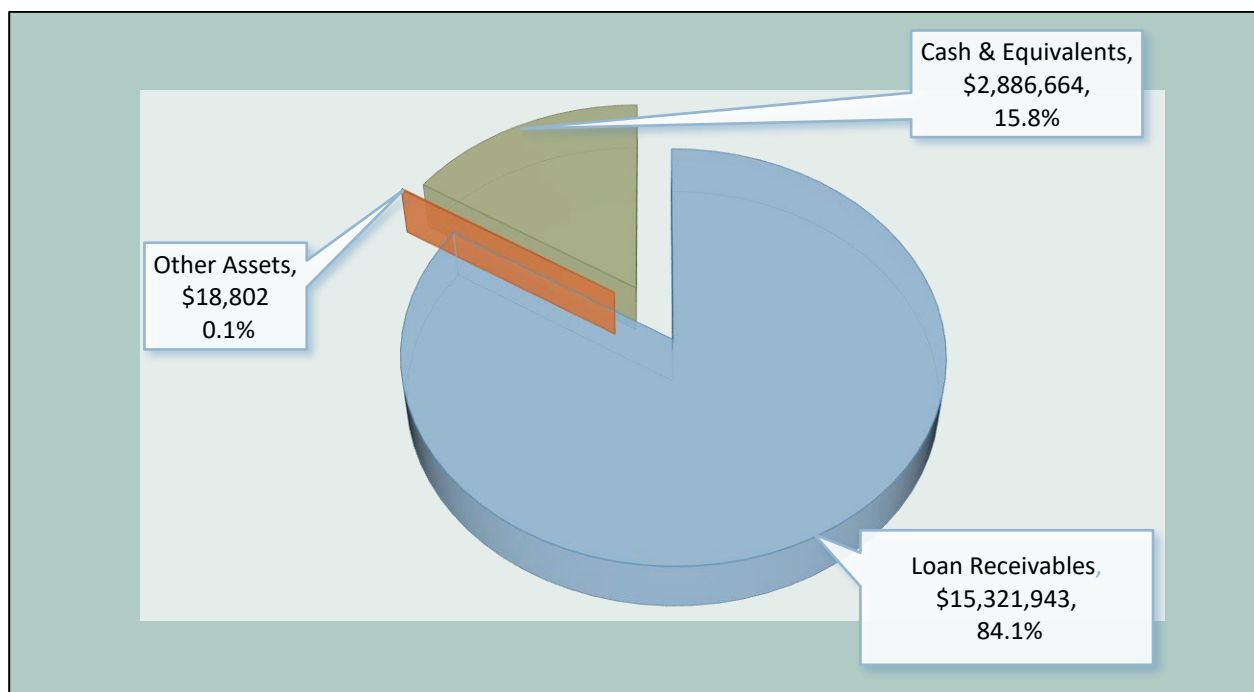
Selected Key Items	2018 Actual	2017 Actual	Variance (\$)	Variance (%)
Loans Receivable	15,321,943	11,919,509	3,402,434	28.5%
Stockholder's Equity	14,552,331	12,373,404	2,178,927	17.6%
Total Assets	17,424,912	15,440,756	1,984,156	12.8%
Retained Earnings	5,224,682	3,070,755	2,153,927	70.1%
Gross Revenue	3,385,475	1,744,328	1,641,147	94%
Total Operating Expenses	631,548 (1)	473,779	157,769	33.3%
Provision for Loan Losses	600,000	150,395 (3)	449,605	298.9%
Net Income (2)	2,153,927	1,120,154	1,033,773	92.3%

(1) Excludes provision for loan losses and interest expense

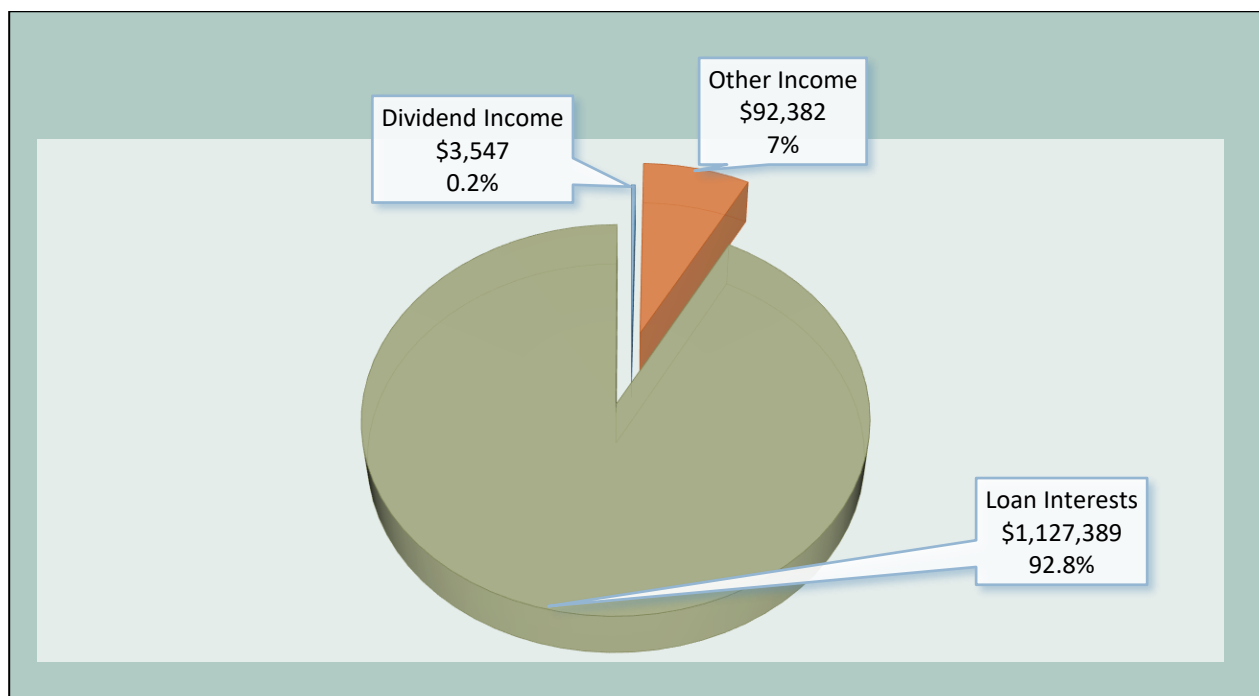
(2) Includes \$2,250,000 funds infused by Yap State govt. for business loan program

(3) Includes provision for interest receivable

Asset Mix

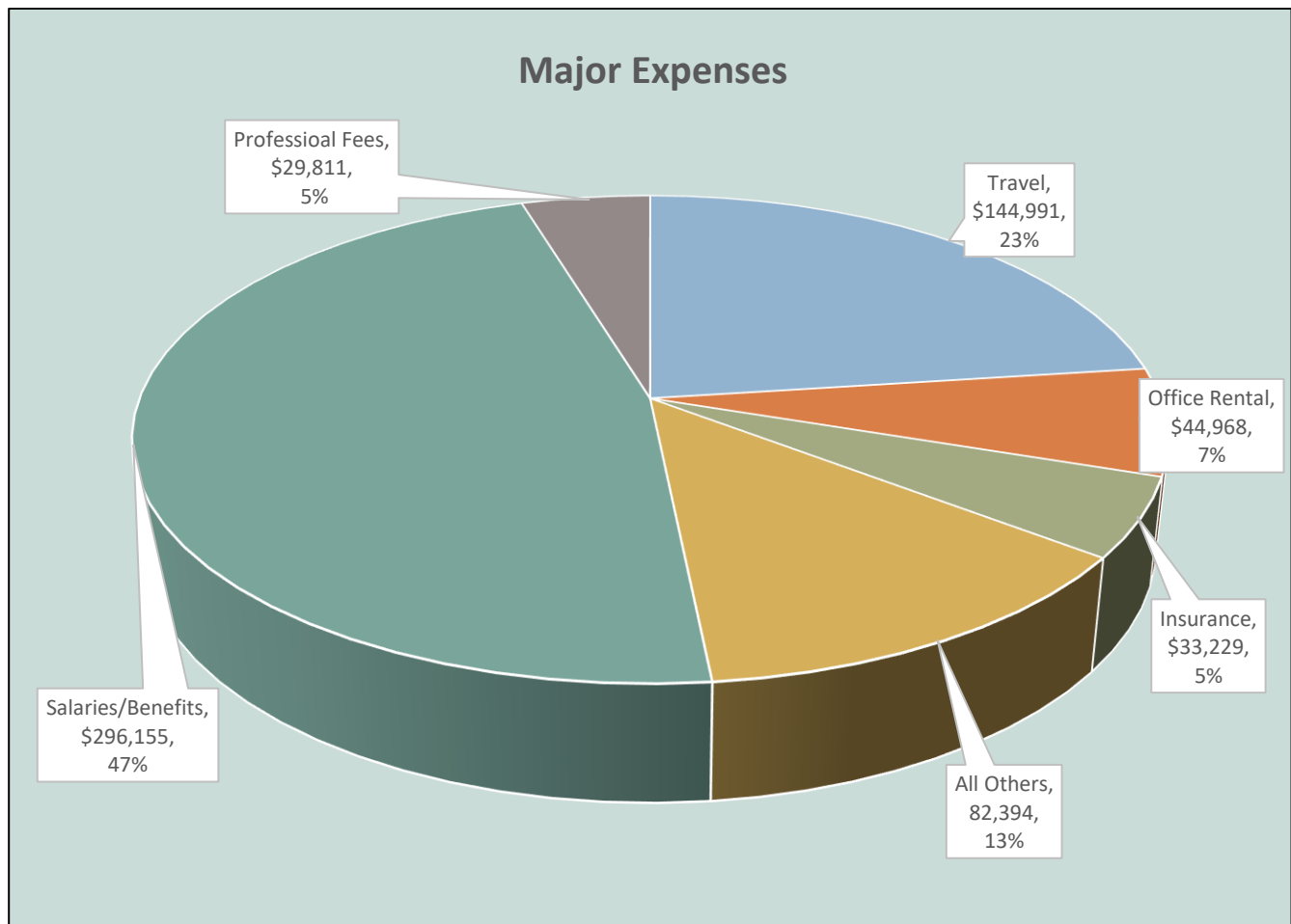


Revenue by Source

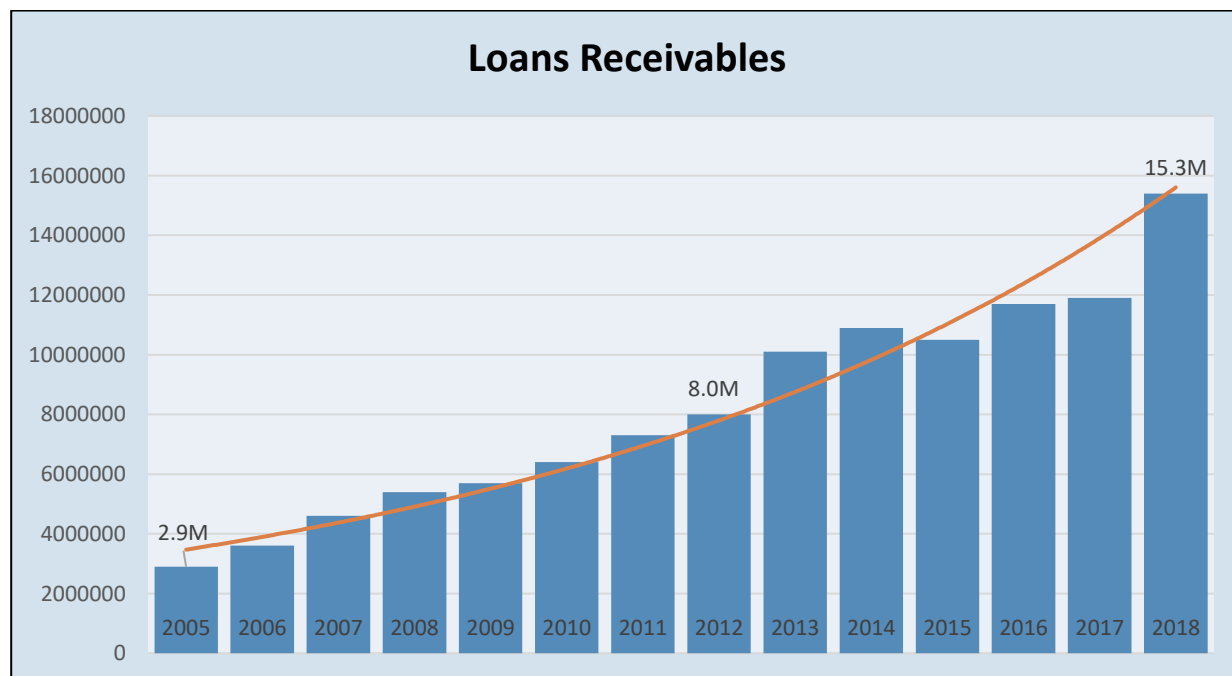
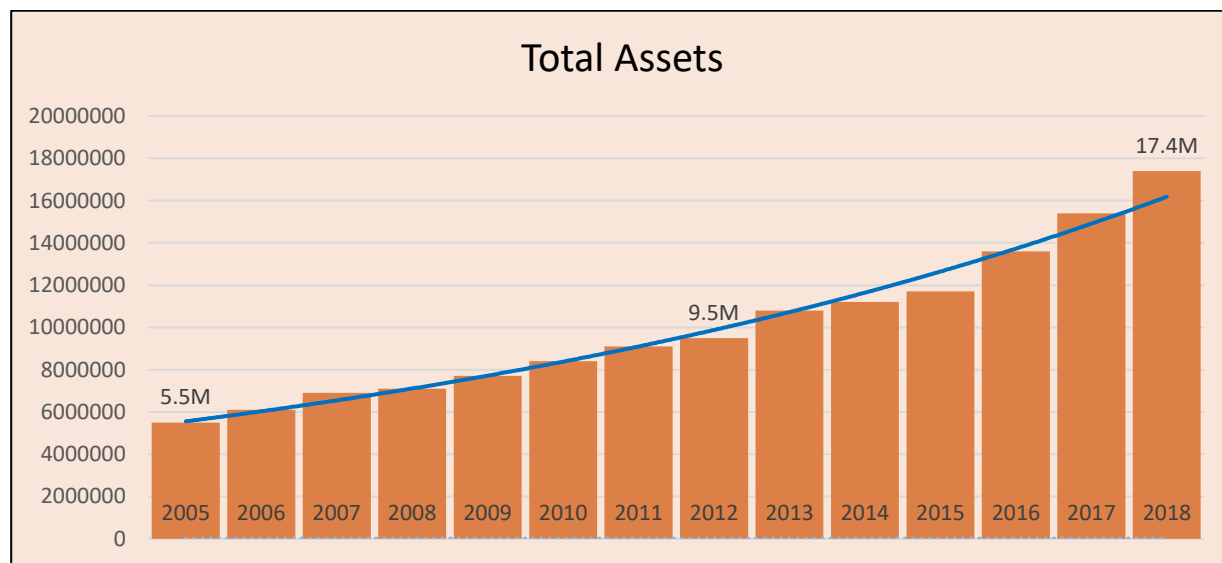


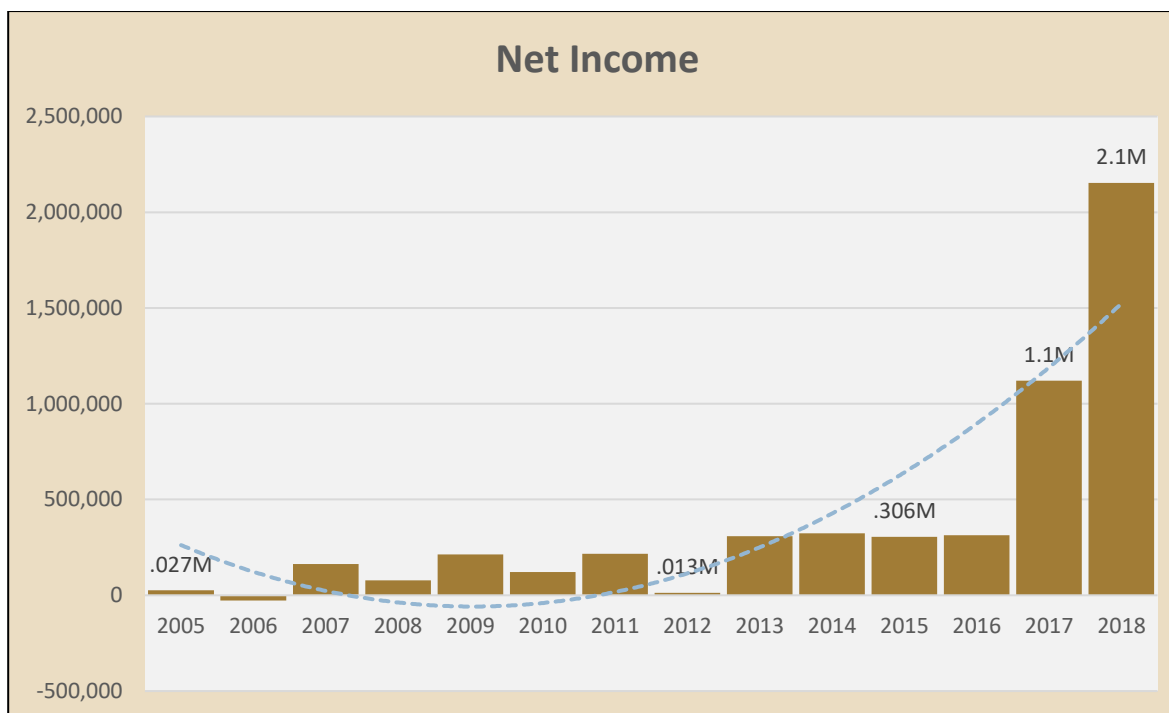
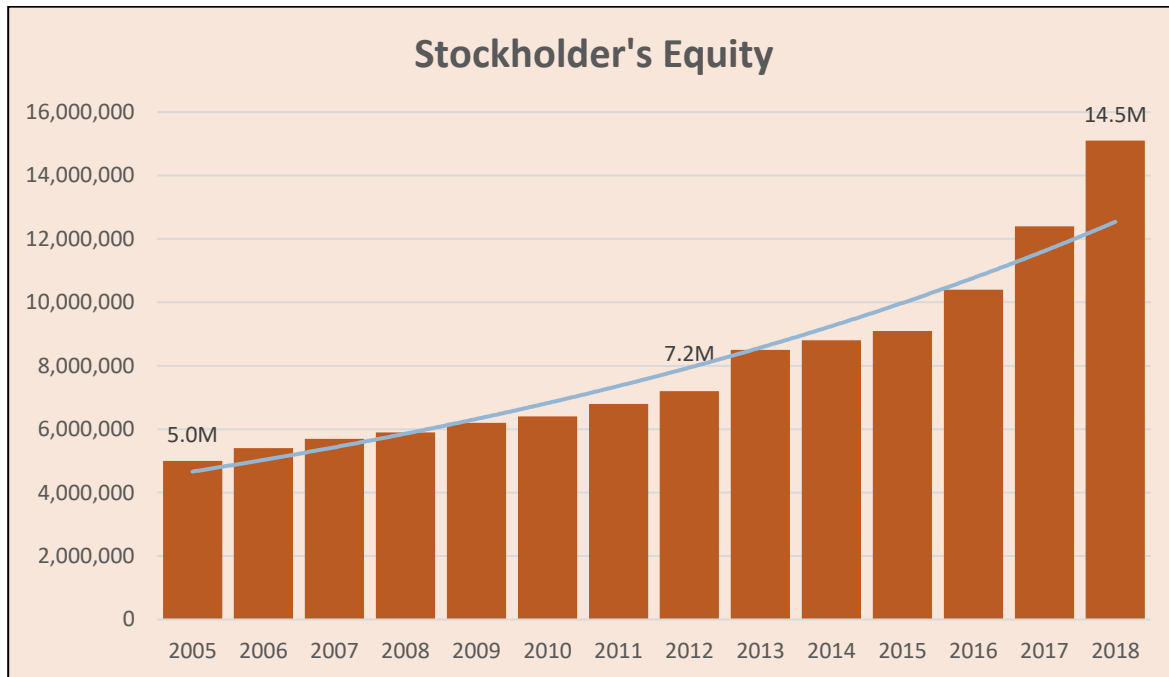
Major Expenses

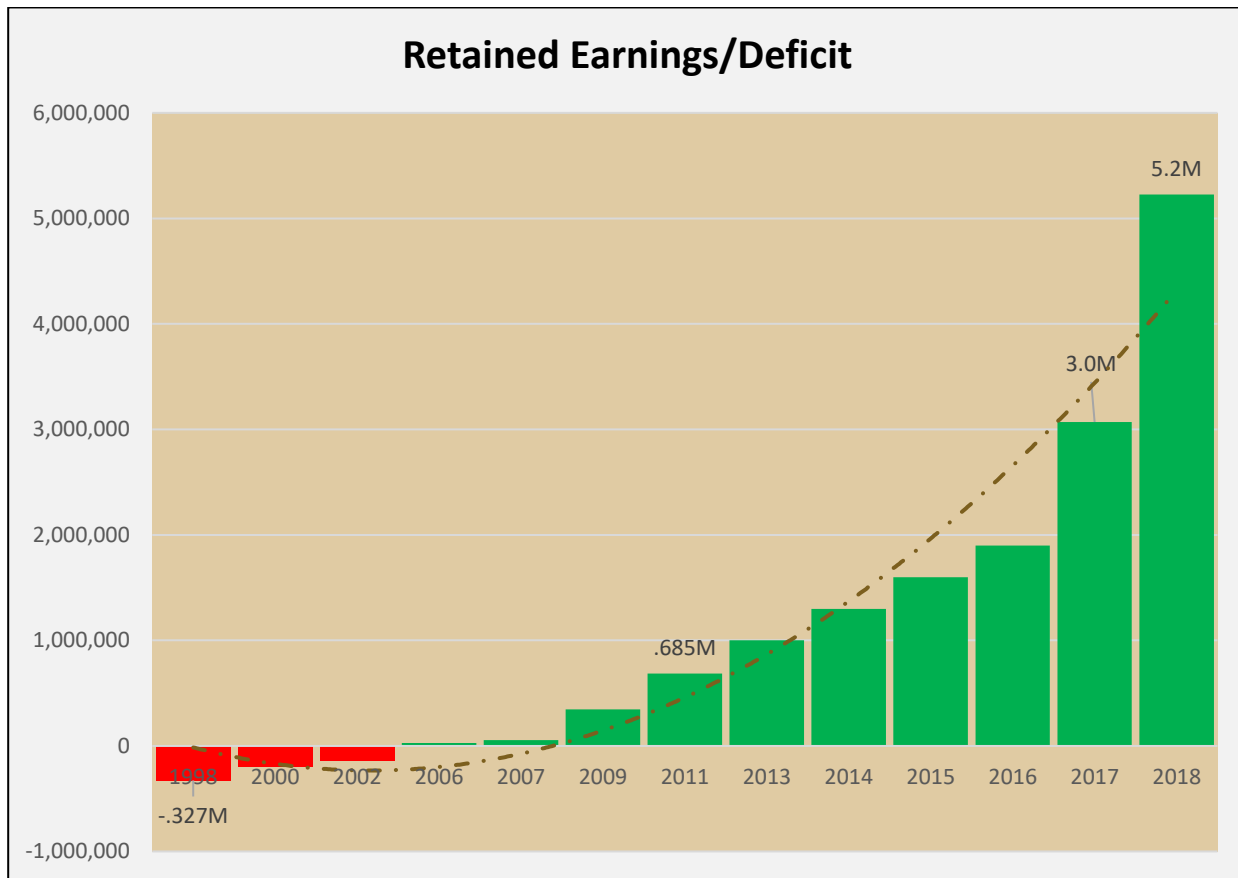
The Bank's operating expenses reflect its operational structure and geographical representation with a 14-member Board of Governors and a 9-member Board of Directors. The Bank's corporate office is currently in Guam with no branch offices yet. Above said, Travel and Communication expenses, are higher comparatively speaking. The annual Provision for Loan Losses is based on the Board of Directors' quarterly review and grading of the bank's loan portfolio and the Auditor's recommendation. Based on such review, the Bank provisioned \$600,000 for 2018. Interest Expense in the amount of \$70,692 was for both the IRP loans and the FSM Development Bank export loan facility. The Table below shows the major expenses of the bank, as a percentage of total operating expenses, during the period under review.



Financial Summary, 2005 – 2018







Selected Financial Ratios

Selected Ratios	2012	2013	2014	2015	2016	2017	2018
GROWTH							
Total Asset Growth	5%	14%	4%	4.2%	16.6%	13.2%	12.8%
Loan Growth	10%	25%	8%	-2.7%	10.7%	1.8%	28.5%
Long Term Debt	0.2%	3%	2%	5.7%	25.1%	-3.9%	-5.3%
Net Worth Growth	6%	18%	4%	3.6%	14.2%	18.4%	17.6%
PROFITABILITY							
Return on Assets	0.13%	2.9%	2.9%	2.6%	2.3%	7.2%	12.3%
Return on Equity	0.18%	3.6%	3.7%	3.3%	3.0%	9.1%	14.8%
Net Margin	2%	30%	34%	32%	34%	107%	63%
LEVERAGE							
Net Worth	7.2M	8.5M	8.9M	9.1M	10.4M	12.3M	14.5M
Debt to Worth	32%	28%	27%	28%	31%	25%	19.5%
Total Liabilities/Total Assets	25%	22%	21%	22%	23%	20%	16%
LIQUIDITY							
Working Capital	\$1.9M	\$1.3M	\$.9M	\$1.3M	\$2.3M	\$3.9M	\$3M
Current Ratio	425	279	127	186	268	312	112

Board Activities During the Year (2018)

A. Board of Governors

1. The Board of Governors met in Pohnpei in April 2018 and took the following actions:
 - Reviewed and approved amendments to the Bank's Articles and Bylaws.
 - Received and reviewed the Bank's 2017 Annual Report and Audit Report.
 - Received the Bank's 2018 Budget and Goals for information.
 - Encouraged the Bank to continue seeking funds from JBIC and ICDF Taiwan and other international donor agencies and organizations.
 - Conducted annual review of President/CEO's performance.
 - Reorganized and elected the following new officers: Governor Swenny Ongidobel as Chairman, Governor Joseph Guerrero as Vice Chairman and Governor Kenneth Kedi as Secretary.

B. Board of Directors

1. Held 4 regular meetings during the year to review bank operation and performance against budget and strategic plan targets; quarterly review of Allowance for Loss reserve account; and took action on loans above the President's lending authority of \$100,000.
2. Prepared and submitted to the Board of Governors 2017 Annual Report and Audit Report.
3. Reviewed and approved budget and goals for the ensuing year (2018).
4. Monitor and assist all efforts to secure additional capital and funding with quarterly review and update.
5. Hired a new Vice President to assist in achieving key goals and objectives and the overall operations of the Bank.
6. Conducted annual performance review of the President/CEO and provided comments to the Board of Governors.

Pacific Islands Development Bank

Financial Statements and Independent Auditors' Report

Years Ended December 31, 2018 and 2017

PACIFIC ISLANDS DEVELOPMENT BANK

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED DECEMBER 31, 2018 AND 2017

Independent Auditors' Report

The Board of Governors and the Board of Directors
Pacific Islands Development Bank:

We have audited the accompanying financial statements of Pacific Islands Development Bank (the Bank), which comprise the statements of condition as of December 31, 2018 and 2017, and the related statements of income, of changes in stockholders' equity and of cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Bank's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pacific Islands Development Bank as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

March 25, 2019

PACIFIC ISLANDS DEVELOPMENT BANK

Statements of Condition
December 31, 2018 and 2017

<u>ASSETS</u>	<u>2018</u>	<u>2017</u>
Cash and cash equivalents	\$ 2,886,664	\$ 3,979,226
Loans receivable, net	14,321,927	11,242,552
Interest receivable, net of an allowance of \$21,003 at 2017	197,519	173,517
Property and equipment, net	<u>18,802</u>	<u>45,461</u>
	<u>\$ 17,424,912</u>	<u>\$ 15,440,756</u>
 <u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
Liabilities:		
Other liabilities	\$ 27,368	\$ 30,361
Long-term debt	<u>2,845,213</u>	<u>3,036,991</u>
Total liabilities	<u>2,872,581</u>	<u>3,067,352</u>
Commitments		
Stockholders' equity:		
Capital stock	9,327,649	9,302,649
Retained earnings	<u>5,224,682</u>	<u>3,070,755</u>
Total stockholders' equity	<u>14,552,331</u>	<u>12,373,404</u>
	<u>\$ 17,424,912</u>	<u>\$ 15,440,756</u>

See accompanying notes to financial statements.

PACIFIC ISLANDS DEVELOPMENT BANK

Statements of Income Years Ended December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Loan interest income	\$ 1,127,389	\$ 1,038,661
Other interest and dividend income	<u>3,547</u>	<u>2,777</u>
	1,130,936	1,041,438
Provision for loan losses	600,000	68,000
Provision for interest receivable	<u>-</u>	<u>82,395</u>
	<u>530,936</u>	<u>891,043</u>
Operating expenses:		
Salaries and related expenses	296,155	236,113
Conference and travel	144,991	112,447
Office rental	44,968	20,784
Insurance	33,229	28,901
Professional fees	29,811	19,302
Depreciation	21,999	15,084
Office supplies	12,069	7,536
Communications	9,385	6,337
Board meetings	7,651	7,750
Business development and marketing	5,525	4,676
Automobile	3,300	1,780
Miscellaneous	<u>22,465</u>	<u>13,069</u>
Total operating expenses	<u>631,548</u>	<u>473,779</u>
Operating (loss) income	<u>(100,612)</u>	<u>417,264</u>
Other income (expense):		
Restricted contributions from Yap State Government	2,250,000	750,000
Other income	92,382	36,439
Loss on disposal of property and equipment	(17,151)	-
Interest expense	<u>(70,692)</u>	<u>(83,549)</u>
Total other income, net	<u>2,254,539</u>	<u>702,890</u>
Net income	<u>\$ 2,153,927</u>	<u>\$ 1,120,154</u>

See accompanying notes to financial statements.

PACIFIC ISLANDS DEVELOPMENT BANK

Statements of Changes in Stockholders' Equity Years Ended December 31, 2018 and 2017

	Shares of Common Stock	Common Stock	Retained Earnings		Total	Total
			Appropriated	Unappropriated		
Balance at December 31, 2016	8,502	\$ 8,502,649	\$ -	\$ 1,950,601	\$ 1,950,601	\$ 10,453,250
Issuance of common stock	800	800,000	-	-	-	800,000
Net income	-	-	750,000	370,154	1,120,154	1,120,154
Balance at December 31, 2017	9,302	9,302,649	750,000	2,320,755	3,070,755	12,373,404
Issuance of common stock	25	25,000	-	-	-	25,000
Net income	-	-	2,250,000	(96,073)	2,153,927	2,153,927
Balance at December 31, 2018	<u>9,327</u>	<u>\$ 9,327,649</u>	<u>\$ 3,000,000</u>	<u>\$ 2,224,682</u>	<u>\$ 5,224,682</u>	<u>\$ 14,552,331</u>

See accompanying notes to financial statements.

PACIFIC ISLANDS DEVELOPMENT BANK

Statements of Cash Flows Years Ended December 31, 2018 and 2017

	<u>2018</u>	<u>2017</u>
Cash flows from operating activities:		
Net income	\$ 2,153,927	\$ 1,120,154
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	21,999	15,084
Provision for loan loss	600,000	68,000
Provision for interest receivable	-	82,395
Restricted contributions from Yap State Government	(2,250,000)	(750,000)
Loss on disposal of property and equipment	17,151	-
Increase in interest receivable	(24,002)	(69,560)
(Decrease) increase in other liabilities	<u>(2,993)</u>	<u>5,125</u>
Net cash provided by operating activities	<u>516,082</u>	<u>471,198</u>
Cash flows from investing activities:		
Loan originations and repayments, net	(3,679,375)	(204,008)
Additions to property and equipment	<u>(12,491)</u>	<u>(4,445)</u>
Net cash used in investing activities	<u>(3,691,866)</u>	<u>(208,453)</u>
Cash flows from financing activities:		
Repayment on long-term debt	(191,778)	(130,214)
Proceeds from issuance of capital stock	25,000	800,000
Restricted contributions from Yap State Government	<u>2,250,000</u>	<u>750,000</u>
Net cash provided by financing activities	<u>2,083,222</u>	<u>1,419,786</u>
Net change in cash and cash equivalents	(1,092,562)	1,682,531
Cash and cash equivalents at beginning of year	<u>3,979,226</u>	<u>2,296,695</u>
Cash and cash equivalents at end of year	<u><u>\$ 2,886,664</u></u>	<u><u>\$ 3,979,226</u></u>
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest	<u><u>\$ 70,692</u></u>	<u><u>\$ 83,549</u></u>

See accompanying notes to financial statements.

PACIFIC ISLANDS DEVELOPMENT BANK

Notes to Financial Statements
December 31, 2018 and 2017

(1) Organization and Summary of Significant Accounting Policies

Organization

Pacific Islands Development Bank (the Bank) was created on July 5, 1989 to provide financial and technical expertise to persons and businesses within the Pacific Island region.

The accounting and reporting policies of the Bank are in accordance with accounting principles generally accepted in the United States of America and conform to general practices within the banking industry. The more significant of the principles used in preparing the financial statements are briefly described below.

In August 2001, the Bank was recognized as a non-profit 501c(3) corporation by the Government of Guam. However, the Bank's characterization of its capital stock has yet to be resolved with Guam authorities. Therefore, the Bank has continued its historic financial statement presentation and has yet to adopt not-for-profit financial reporting.

Cash and Cash Equivalents

For the purposes of the statements of condition and cash flows, cash and cash equivalents are defined as cash on hand, in banks and in money market funds. Time certificates of deposit with initial maturities in excess of ninety days are separately classified.

Loans

Loans are stated at unpaid principal balance less the allowance for loan losses (the "Allowance"). Interest income is recognized on an accrual basis. Other credit-related fees are recognized as fee income, a component of noninterest income, when earned.

Non-Performing Loans

Generally, loans are placed on non-accrual status upon becoming contractually past due 90 days as to principal or interest (unless loans and leases are adequately secured by collateral, are in the process of collection, and are reasonably expected to result in repayment), when terms are renegotiated below market levels, or where substantial doubt about full repayment of principal or interest is evident.

When a loan is placed on non-accrual status, the accrued and unpaid interest receivable is reversed and the loan is accounted for on the cash or cost recovery method until qualifying for return to accrual status. All payments received on non-accrual loans are applied against the principal balance of the loan. A loan may be returned to accrual status when all delinquent interest and principal become current in accordance with the terms of the loan and when doubt about repayment is resolved. At December 31, 2018 and 2017, two loans totaling \$744,253 are on non-accrual status and as such, no interest income or accrued interest receivable have been recognized.

Impaired Loans

A loan is considered impaired when, based on current information and events, it is probable that the Bank will not be able to collect all amounts due from the borrower in accordance with the contractual terms of the loan, including scheduled interest payments. Impaired loans include all non-accruing loans, all loans modified in a troubled debt restructuring and loans classified as doubtful (see note 3).

PACIFIC ISLANDS DEVELOPMENT BANK

Notes to Financial Statements
December 31, 2018 and 2017

(1) Organization and Summary of Significant Accounting Policies, Continued

Impaired Loans, Continued

When a loan has been identified as being impaired, the amount of impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price, or the estimated fair value of the collateral, less any selling costs, if the loan is collateral-dependent. If the measurement of the impaired loan is less than the recorded investment in the loan (including accrued interest), an impairment is recognized by establishing or adjusting an existing allocation of the Allowance.

Loans Modified in a Troubled Debt Restructuring (TDRs)

Loans are considered to have been modified in a troubled debt restructuring when, due to a borrower's financial difficulties, the Bank makes certain concessions to the borrower that it would not otherwise consider. Modifications may include interest rate reductions, principal or interest forgiveness, forbearance, and other actions intended to minimize economic loss and to avoid foreclosure or repossession of collateral. A modification that results in an insignificant delay in contractual cash flows is not considered to be a concession. During the years ended December 31, 2018 and 2017, the Bank granted loan modifications and temporary payment deferments.

Allowance for Loan Losses and Accrued Interest

The Bank maintains an Allowance adequate to cover management's estimate of probable credit losses as of the statement of condition date. Changes to the level of the Allowance are recognized through charges or credits to provisions for loan losses. Loans that are charged-off reduce the Allowance while recoveries of loans previously charged-off increase the Allowance.

The Bank does not disaggregate its loan portfolio by segments for the purposes of determination of the Allowance. The level of Allowance is generally based on analyses of individual borrowers and historical loss experience supplemented as necessary by credit judgment to address observed changes in trends and conditions, and other relevant environmental and economic factors that may affect the collectability of loans. On a quarterly basis, the Bank performs an analysis of individual loans based on its internal risk rating methodology.

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. Depreciation on all property and equipment is computed under the straight-line method over the estimated useful lives of the assets or, for leasehold improvements over the term of lease.

Taxation

The Bank is not subject to taxation within Guam and therefore, no provision for taxes is included within the accompanying financial statements.

PACIFIC ISLANDS DEVELOPMENT BANK

Notes to Financial Statements
December 31, 2018 and 2017

(1) Organization and Summary of Significant Accounting Policies, Continued

Significant Group Concentration of Credit Risk

All of the Bank's lending activities are with individuals and businesses located within Guam, the Commonwealth of the Northern Mariana Islands, the Federated States of Micronesia, the Republic of the Marshall Islands, and the Republic of Palau.

As of December 31, 2018, loan to one borrower aggregated \$1.6 million and represented 10.2% of gross loans. The Bank did not have any significant concentrations in a single borrower as of December 31, 2017.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses.

Risks and Uncertainties

In the normal course of its business, the Bank encounters the three components of economic risks: interest rate risk, credit risk and market risk. The Bank is subject to interest rate risk to the degree that its interest-bearing liabilities mature or re-price at different speeds, or on a different basis, than its interest-earning assets. Incorporated into interest rate risk is prepayment risk. Prepayment risk is the risk associated with the prepayment of assets, and the write-off of premiums associated with those assets, if any, should interest rates fall significantly. Credit risk is the risk of default, primarily in the Bank's loan portfolio that results from the borrower's inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of securities, and the value of collateral underlying loans receivable. Credit and market risks can be affected by a concentration of business within the Pacific Island region.

Subsequent Events

Management has evaluated subsequent events through March 25, 2019, which is the date that the financial statements are available to be issued. There were no material subsequent events that would require recognition or disclosure in the financial statements for the year ended December 31, 2018.

(2) Loans Receivable

The loan portfolio consists of direct loans. The interest rates on commercial loans, consumer loans and residential loans are predominately at a fixed rate of 10%, 13% and 7%, respectively. Most commercial and residential loans have been collateralized by various forms of collateral wherein consumer loans are mostly unsecured.

PACIFIC ISLANDS DEVELOPMENT BANK

Notes to Financial Statements
December 31, 2018 and 2017

(2) Loans Receivable, Continued

A summary of the balances of loans at December 31, 2018 and 2017 follows:

	<u>2018</u>	<u>2017</u>
Commercial – PIDB direct loan program	\$ 9,479,907	\$ 6,604,295
Residential loans	3,164,653	2,457,424
Commercial – USDA Intermediary Relending Program (IRP)	878,977	1,066,476
Consumer	806,663	1,000,070
Commercial – FSMDB import/export	<u>991,743</u>	<u>791,244</u>
Gross loans	15,321,943	11,919,509
Less: allowance for loan losses	<u>(1,000,016)</u>	<u>(676,957)</u>
Net loans	\$ <u>14,321,927</u>	\$ <u>11,242,552</u>

In the ordinary course of business, the Bank has entered into transactions with its employees, directors and their affiliates. Such transactions were made on substantially the same terms and conditions, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other customers. The aggregate amount of loans outstanding to such related parties at December 31, 2018 and 2017 was \$819,000 and \$526,000, respectively.

(3) Allowance for Loan Losses

A summary of the changes in the allowance for loan losses for the years ended December 31, 2018 and 2017, follows

	<u>2018</u>	<u>2017</u>
Balance at beginning of year	\$ 676,957	\$ 603,117
Loans charged off	(281,594)	-
Recoveries of loans previously charged off	4,653	5,840
Provision for loan losses	<u>600,000</u>	<u>68,000</u>
Balance at end of year	\$ <u>1,000,016</u>	\$ <u>676,957</u>

Credit Quality Indicators

The Bank uses an internal credit risk rating system that categorizes loans into pass, special mention, substandard or doubtful categories. Credit risk ratings are applied individually to each loan on a quarterly basis.

The following are the definitions of the Bank's credit quality indicators:

Pass: Loans in this category have a high probability of being paid as agreed. The credit carries a level of risk commensurate with the returns provided without placing the Bank in any exposure.

PACIFIC ISLANDS DEVELOPMENT BANK

Notes to Financial Statements
December 31, 2018 and 2017

(3) Allowance for Loan Losses, Continued

Credit Quality Indicators, Continued

Special Mention: Loans in this category have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for default of loan. Special mention loans are not adversely classified and do not expose the Bank to significant risk to warrant such adverse classification.

Substandard: Loans in this category are inadequately protected by the current worth and paying capacity of the obligors or of the collateral pledged. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank may sustain some losses if the deficiencies are not corrected.

Doubtful: Loans classified in this category have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable. Loans classified as Doubtful are considered to be impaired.

The Bank's credit quality indicators are periodically updated on a case-by-case basis. The following presents by class and by credit quality indicator, the recorded investment in the Bank's loans as of December 31, 2018 and 2017:

	<u>Pass</u>	<u>Special mention</u>	<u>Sub- standard</u>	<u>Doubtful</u>	<u>Total</u>
<u>2018</u>					
PIDB direct	\$ 7,850,674	\$ 958,724	\$ 151,431	\$ 519,078	\$ 9,479,907
Residential	2,959,391	18,722	186,540	-	3,164,653
IRP	547,236	40,008	2,643	289,090	878,977
Consumer	726,815	54,928	6,018	18,902	806,663
Import/export	<u>972,123</u>	<u>19,620</u>	<u>-</u>	<u>-</u>	<u>991,743</u>
Total	\$ <u>13,056,239</u>	\$ <u>1,092,002</u>	\$ <u>346,632</u>	\$ <u>827,070</u>	\$ <u>15,321,943</u>
<u>2017</u>					
PIDB direct	\$ 5,750,811	\$ 179,730	\$ 154,851	\$ 518,903	\$ 6,604,295
Residential	2,245,283	25,602	186,539	-	2,457,424
IRP	661,383	65,309	3,550	336,234	1,066,476
Consumer	900,831	22,270	66,966	10,003	1,000,070
Import/export	<u>708,799</u>	<u>7,538</u>	<u>-</u>	<u>74,907</u>	<u>791,244</u>
Total	\$ <u>10,267,107</u>	\$ <u>300,449</u>	\$ <u>411,906</u>	\$ <u>940,047</u>	\$ <u>11,919,509</u>

At December 31, 2018, impaired loans of \$827,070 represent loans classified as Doubtful, with total recorded allowances of \$785,574. Included in these are two loans totaling \$744,253 which were provided with 100% allowance. The loans are significantly past due and no collections have been received or interest income recognized during the years ended December 31, 2018 and 2017. Although the Bank continues to aggressively pursue collection efforts, full provision has been provided as ultimate collectibility is uncertain.

At December 31, 2017, impaired loans of \$940,047 represent loans classified as Doubtful, with total recorded allowances \$470,023.

PACIFIC ISLANDS DEVELOPMENT BANK

Notes to Financial Statements December 31, 2018 and 2017

(3) Allowance for Loan Losses, Continued

The following presents by class, an aging analysis of the Bank's loan portfolio as of December 31, 2018 and 2017:

	<u>Current</u>	<u>30 – 59 Days Past Due</u>	<u>60 – 89 Days Past Due</u>	<u>Past Due 90 Days or More</u>	<u>Total</u>
<u>2018</u>					
PIDB direct	\$ 8,816,452	\$ 23,774	\$ -	\$ 639,681	\$ 9,479,907
Residential	2,757,893	406,760	-	-	3,164,653
IRP	240,375	319,844	-	318,758	878,977
Consumer	684,623	33,818	-	88,222	806,663
Import/export	<u>908,980</u>	<u>82,763</u>	<u>-</u>	<u>-</u>	<u>991,743</u>
Total	\$ <u>13,408,323</u>	\$ <u>866,959</u>	\$ <u>-</u>	\$ <u>1,046,661</u>	\$ <u>15,321,943</u>
<u>2017</u>					
PIDB direct	\$ 5,800,931	\$ 193,504	\$ -	\$ 609,860	\$ 6,604,295
Residential	2,257,424	200,000	-	-	2,457,424
IRP	673,595	-	23,407	369,474	1,066,476
Consumer	739,187	83,184	9,062	168,637	1,000,070
Import/export	<u>677,971</u>	<u>38,366</u>	<u>-</u>	<u>74,907</u>	<u>791,244</u>
Total	\$ <u>10,149,108</u>	\$ <u>515,054</u>	\$ <u>32,469</u>	\$ <u>1,222,878</u>	\$ <u>11,919,509</u>

(4) Property and Equipment

A summary of property and equipment as of December 31, 2018 and 2017, is as follows:

<u>Description</u>	<u>Estimated Useful Lives</u>	<u>2018</u>	<u>2017</u>
Computer and software	5 years	\$ 12,683	\$ 63,700
Vehicles	5 years	37,423	64,946
Leasehold improvements	3 years	639	31,162
Office furniture and equipment	10 years	<u>19,632</u>	<u>29,491</u>
		70,377	189,299
Less accumulated depreciation		<u>(51,575)</u>	<u>(143,838)</u>
		\$ <u>18,802</u>	\$ <u>45,461</u>

PACIFIC ISLANDS DEVELOPMENT BANK

Notes to Financial Statements December 31, 2018 and 2017

(5) Long-Term Debt

Long-term debt as of December 31, 2018 and 2017, consists of the following:

	<u>2018</u>	<u>2017</u>
A \$500,000 Intermediary Relending Program (IRP) loan by the U.S. Department of Agriculture (USDA) on October 7, 2003. Interest fixed at 1% per annum. Interest-only payment for the first three years with twenty-seven equal principal and interest annual installments beginning on October 7, 2007.	\$ 293,296	\$ 311,407
A \$750,000 IRP loan by the USDA on June 27, 2006. Interest fixed at 1% per annum. Interest-only payment for the first three years with twenty-seven equal principal and interest annual installments beginning on June 27, 2010.	520,962	545,812
A \$750,000 IRP loan by the USDA on September 8, 2008. Interest fixed at 1% per annum. Interest-only payment for the first three years with twenty-seven equal principal and interest annual installments beginning on September 8, 2012.	571,667	598,035
A \$350,000 IRP loan by the USDA on March 7, 2013. Interest fixed at 1% per annum. Interest-only payment for the first three years with twenty-seven equal principal and interest annual installments beginning on March 7, 2017.	241,704	256,619
A \$500,000 loan with the FSM Development Bank (FSMDB) on September 16, 2010. Interest fixed at 4% per annum. Interest-only payment for the first three years, thereafter forty equal quarterly installments of \$15,228.	276,214	325,118
A \$1,000,000 loan with FSMDB on March 17, 2015. Interest fixed at 4% per annum. Interest only payments for the first three years, thereafter forty equal quarterly installments of \$30,456.	<u>941,370</u>	<u>1,000,000</u>
Total	\$ <u>2,845,213</u>	\$ <u>3,036,991</u>

The IRP loans are collateralized by all repayments, interest, fees, investments and other revenues collected or generated from the IRP loans. The FSMDB loans are collateralized by the Bank's general assets under a security agreement.

At December 31, 2018, future maturities of long-term debt are as follows:

Year ending December 31,

2019	\$ 213,279
2020	197,146
2021	226,188
2022	233,006
2023	220,331
Thereafter	<u>1,755,263</u>
	\$ <u>2,845,213</u>

PACIFIC ISLANDS DEVELOPMENT BANK

Notes to Financial Statements
December 31, 2018 and 2017

(6) Restricted Contributions

In February 2017, the Bank and the Yap State Government entered into a Memorandum of Understanding (MOU) pursuant to Yap State Law No. 9-35 (the Act) dated July 2016. The Act authorizes the appropriation of \$3 million for the purpose of funding a Yap State development loan program to be administered by the Bank. Under the MOU, the Bank is essentially performing all underwriting, disbursement, credit administration activities relating to funded loans and makes periodic reports to Yap State. The MOU also sets forth eligibility requirements, including business sector, borrower citizenship and residency requirements, as well as loan requirements, such as collateral and interest rate. Due to the restrictions associated with the program, contributions received in the amount of \$2,250,000 and \$750,000 during the years ended December 31, 2018 and 2017, respectively, are included as part of appropriated retained earnings.

As of December 31, 2018, six loans totaling \$3,992,777, of which \$3 million has been funded under the program. Total outstanding balance of these loans at December 31, 2018 was \$3,593,162 and is included as a component of loans receivable in the accompanying statements of condition.

(7) Leases

The Bank operates from a leased office space with monthly lease payments of \$5,325 starting July 2018 through June 2028. Previously, it occupied an office space at a monthly rent of \$1,732, plus allocation of utility charges, through June 30, 2018.

Future commitment under the lease is as follows:

Year ending December 31,

2019	\$ 63,900
2020	63,900
2021	63,900
2022	63,900
2023	63,900
Thereafter	<u>287,550</u>
	\$ <u>607,050</u>

Additionally, the Bank entered into a five-year equipment lease in October 2014. The lease calls for monthly fixed payments of \$210 with additional excess-usage charges.

(8) Employee Benefit Plan

The Bank has a 401(k) Plan whereby substantially all employees participate in the Plan after meeting certain eligibility requirements, namely, completion of one year of continuous employment. Contributions to the Plan are 10% of gross salaries and are 100% vested after three years of service. During the years ended December 31, 2018 and 2017, the Bank contributed \$15,137 and \$10,763, respectively, to the Plan.