

2016 Annual Report

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."

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Transmittal Letter

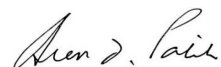
March 31, 2017

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, 2016.

Respectfully,



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

Message from the President

The year under review, 2016, was one of the most productive years yet, marking the third year of implementation of the Bank's revised Five-Year Strategic Plan covering the period 2014 to 2018. Our focus remained on growth related initiatives and strategies outlined in the Plan and further illustrated in our 2016 Budget & Goals. Resource mobilization and capacity enhancement, especially capitalization and funding, is critically important to fulfilling the Bank's mission and purpose. In that regard, the FSM State of Yap approved \$3 million to establish a business development loan program in Yap. Yap State and PIDB entered into a Memorandum of Agreement outlining the terms and conditions of the program and to ensure that the program is implemented in accordance with Yap State law. PIDB was selected as the Administrator of the program based on its track record. In 2016, the Republic of the Marshall Islands also infused an additional \$1 million in equity capital, increasing its membership capital to \$2 million. We thank Yap State and RMI for their additional contribution, support, and commitment.


Operationally, I am pleased to report that the Bank once again registered strong balance sheet growth and performance and sustained earnings. Following are some of the key accomplishments and highlights of the period under review:

- *Total Assets increased by 16.5% or \$1.9 million to \$13.6 million*
- *Loans Receivables increased by 10.9% or \$1.1 million to \$11.7*
- *Stockholders' Equity increased by 14.2% or \$1.3 million to \$10.4 million*
- *Retained Earnings increased by 19.1% or \$312,888 to \$1.9 million*
- *Realized a net income of \$392,888 before a \$80,000 provision to the Loan Loss Reserve*
- *Realized a Return on Assets of 2.3%*
- *Realized a Return on Equity of 2.9%*
- *Reduced loan delinquency to 8.2% from 12.4% in 2015*
- *Reduced loan charge offs to \$26,268 from \$222,816 in 2015*
- *Achieved "unqualified" audit opinion with no questioned costs and documentation issue*

During the year, efforts to secure new associate members were pursued. Certain corporate issues regarding associate membership including voting privileges of new members need to be reviewed and addressed by the Board. To that end, the Board of Governors, in its last meeting in April 2016, directed the CEO and Board of Directors to perform a comprehensive review of the Bank's Articles of Agreement and Bylaws and to propose amendments that would address and resolve these corporate issues. The review was completed during the year and recommendations will be submitted to the Board of Governors at its annual meeting in April 2017. This is the first time since the inception of the Bank that such a comprehensive review of the bank's Articles and Bylaws has been sanctioned.

Looking ahead, the 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" is clear yet challenging. To realize that Vision and capture the opportunities that lie ahead, we must continue to use our Strategic Plan as our guide and compass. Strategic planning has proven effective in charting our course and ensuring organizational success. Our main goals and objective for the next five years, as outlined in the Plan, are as follows: (1) increase the bank's resource base and capacity, (2) effectively manage credit risks, (3) manage and increase return on securities investment, (4) diversify and expand products and services, (5) manage our margins by increasing revenue and controlling expenses; and (6) ensure a prudent operation complying with applicable laws and regulations and internal bank policies and procedures.

In closing, we express our gratitude and thank our Shareholders for their unwavering support and commitment. We also acknowledge and thank the members of our Board of Governors, Board of Directors, and our staff for their diligence and dedication without which our remarkable achievements in 2016 would not have been possible.



Aren Palik
President & CEO

I. Background & Corporate Information

Establishment

Pacific Islands Development Bank was established in July 1989 by the Association of Pacific Island Legislatures. Its corporate office is located 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

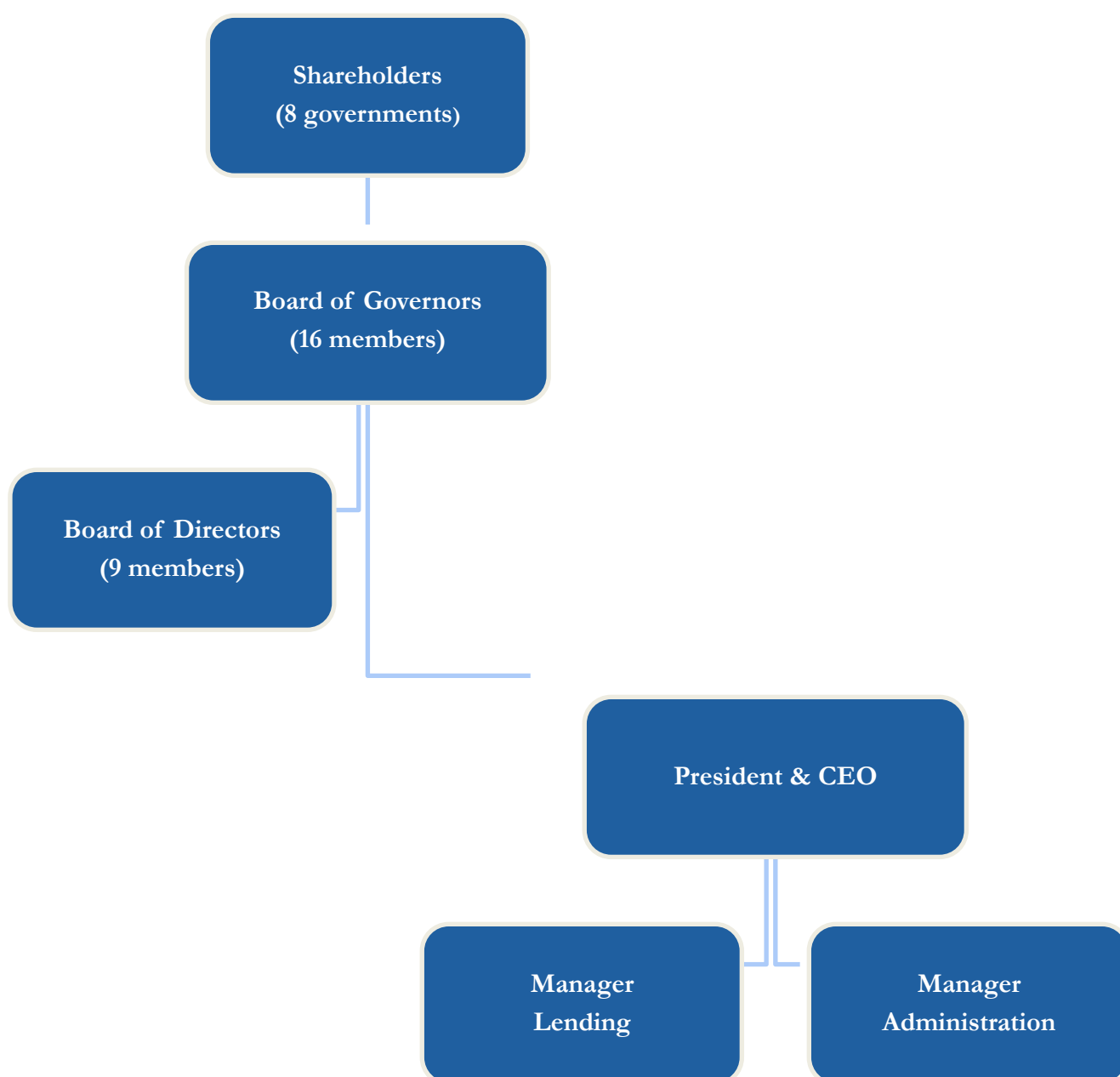
"To contribute to the acceleration of the process of economic and social development of member countries and States, individually and collectively, and to promote economic cooperation among them."

Shareholders & Paid in Capital

Shareholders	2016	
	# Shares	Value
Chuuk	251	251,783
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	1,000	1,000,000
Yap	1,439	1,438,866
Total	8,502	\$8,502,649

For the period under review, the Bank has 8 Shareholders. Each member entity is required to contribute an initial capital of \$1 million. RMI infused an additional \$1 million capital in 2016. The FSM States of Kosrae and Chuuk have yet to fulfill their initial capital membership of \$1 million.

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 and one 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 Congressman
Guam:	Eddie Calvo Governor	Judith Won Pat, Chairperson Speaker
Kosrae:	Carson Sigrah Lt. Governor	Tulensa Palik Speaker
Marshall Is.	Brenson Wase Minister of Finance	Kenneth Kedi Speaker
Palau:	Elbuchel Sadang Minister of Finance	Swenny Ongidobel, Secretary Delegate, House of Delegates, OEK
Pohnpei:	Reed Oliver, Vice Chairman Lt. Governor	Vacant
Yap:	Tony Ganngiyan, Chairman Governor	Joseph Giliko Vice Speaker

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, subject to the approval of a majority of the Board of Governors, one person to represent that member entity on the PIDB Board of Directors. In accordance with the *Articles*, the Bank President & CEO serves as Chairman of the Board of Directors.

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

Palau	CNMI	Guam
Elbuchel Sadang Minister of Finance Republic of Palau	Diego Benavente Former Lt. Governor/ Former Speaker	Lourdes Leon Guerrero President & CEO Bank of Guam
Kosrae	Pohnpei	Yap
Palokoa George Accountant Dept. of Administration	Christina Elnei Acting Director Dept. of Treasury/Admin.	John Masiwemai Senator Yap State Legislature
Management	Marshall Islands	Chuuk
Aren Palik President/CEO Chairman of the Board	Alfred Alfred, Jr. Minister of Resources & Development	Vacant

II. 2016 Operational Summary

A. Loan Report

Approved Loans

Loan Type	2016 No. of Loans	Amount	2015 No. of Loans	Amount
Commercial Loans				
Agriculture	0	0	0	0
Fisheries	1	100,000	1	20,000
Tourism	1	9,000	0	0
Manufacturing	1	100,000	0	0
Services	6	1,010,699	12	748,624
Commercial	2	400,000	2	126,839
Sub Total	11	1,619,699	15	895,477
Residential Home Loans	8	523,109	4	249,900
Consumer Loans	79	794,325	60	520,294
Total	98	\$2,937,133	79	\$1,665,671

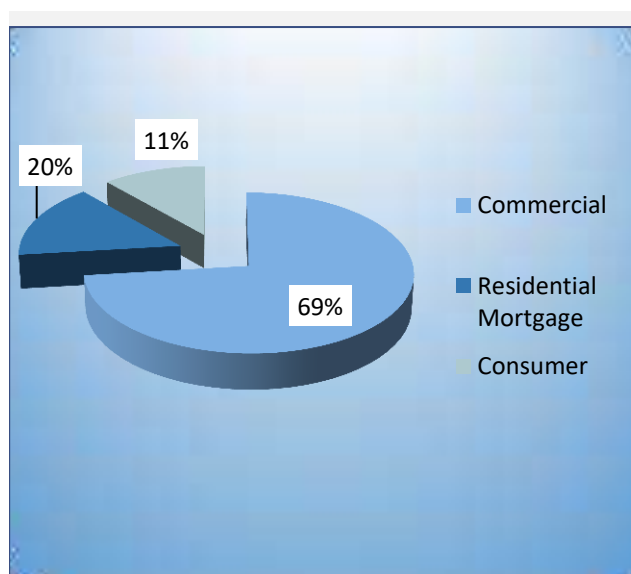
Outstanding Loans by Sector

Loan Type	2016 #	Amount \$	2015 #	Amount \$
Commercial Loans				
Agriculture	3	627,798	1	4,551
Fisheries	3	152,953	4	880,388
Tourism	7	935,006	7	897,492
Manufacturing	1	265,148	4	363,412
Services	46	2,802,532	57	4,107,470
Commercial	24	3,255,590	10	1,384,141
Sub Total	84	8,039,027	83	7,637,454
Residential Home Loans	34	2,329,195	26	1,868,348
Consumer Loans	185	1,341,439	156	1,070,125
Total	303	11,709,661	265	\$10,575,927

Loan Distribution by Shareholder

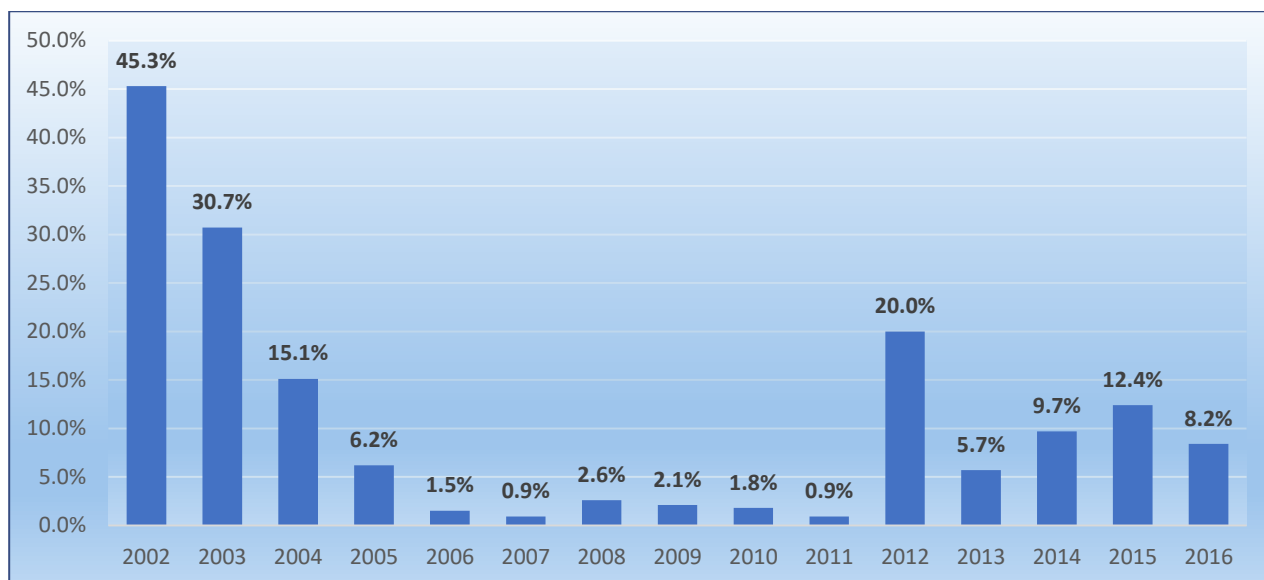
Shareholder	Commercial		Consumer		Housing		Total	
	#	Value	#	Value	#	Value	#	Value
Guam	6	659,572	57	344,007	2	199,309	65	1,202,888
Palau	7	1,074,713	7	54,803	1	78,706	15	1,208,222
Pohnpei	4	203,886	6	79,625	3	154,846	13	438,357
Yap	16	1,818,306	66	481,297	5	344,619	87	2,644,222
Kosrae	29	873,307	37	249,637	13	323,333	79	1,446,277
CNMI	4	1,174,303	7	71,794	3	251,168	14	1,497,265
Chuuk	1	43,538	0	0	0	0	1	43,538
RMI	11	1,819,831	5	60,276	3	553,060	19	2,433,167
FSMDB/Export	6	371,571	0	0	4	424,154	10	795,725
Total	84	\$8,039,027	185	\$1,341,439	34	\$2,329,195	303	\$11,709,661

Loan Mix

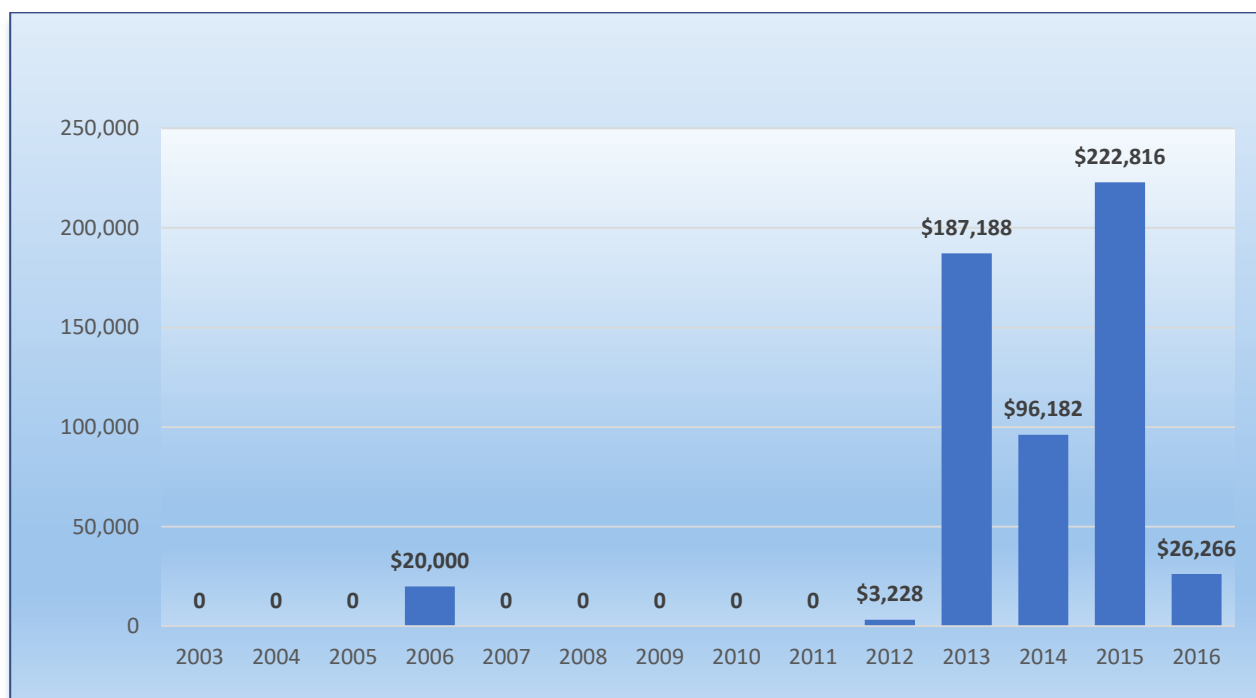


At 12/31/16, 69% or \$8.0 million of Total Loans was in Commercial Loans; 20% or \$2.3 million in Residential Home Loans; and 11% or \$1.3 million in Consumer Loans. The Bank's core lending is in Commercial loans, consistent with its core mission and purpose. For the period under review, average Consumer Loan per borrower is \$7,251; average Residential Home Loans is \$68,506; and average Commercial loan per borrower is \$95,703.

Loan Delinquency



Loan Charge Offs



B. Financial Report

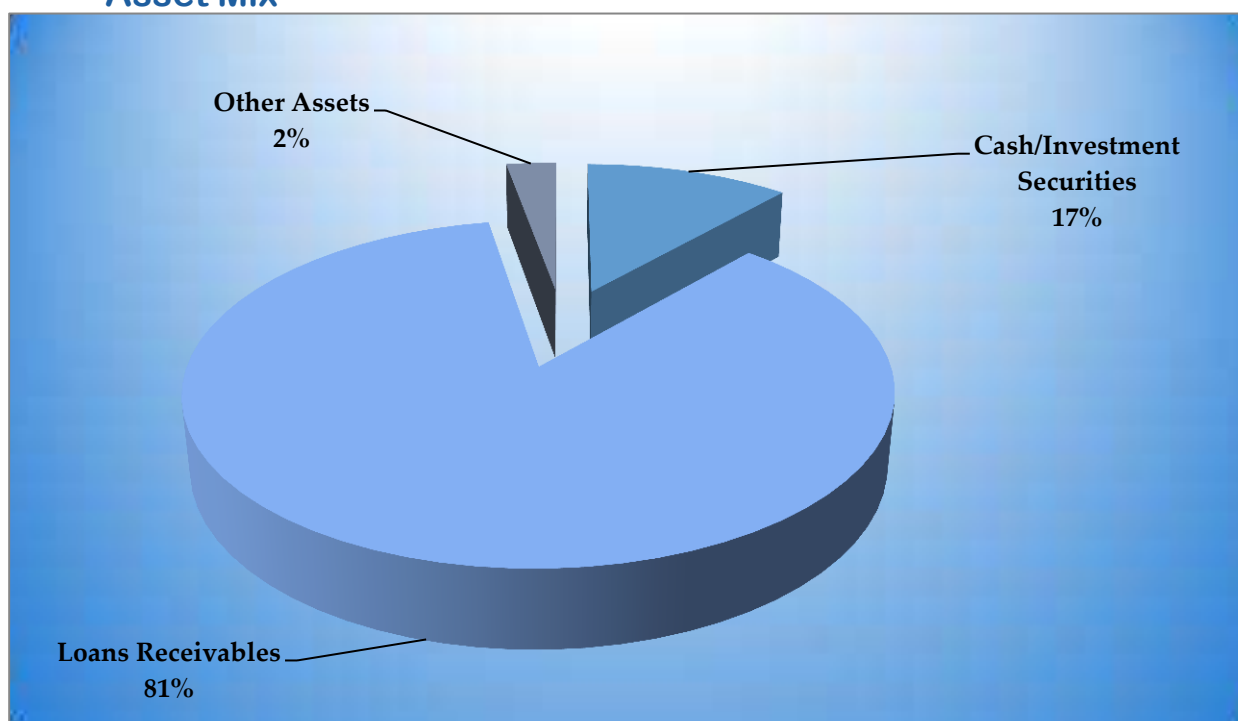
Performance Against Previous Year (2015)

For the period under review, Loans Receivable increased by 10.7% or \$1.1 million to \$11.7 million. The increase is attributed to increased loan demand and viable and bankable loan packages. Stockholders' Equity grew by 14.3% or \$1.3 million to \$10.4 million due primarily to improvement in the Bank's Retained Earnings and additional equity capital infusion from the Republic of the Marshall Islands. Total Assets also saw a significant increase of 16.6% or \$1.9 million to \$13.6 million due mainly to additional capital infusion, strong stockholders' equity performance and the multiplier effect on the loan portfolio. Retained Earnings registered consistent growth as seen in recent years by 19.1% to \$1.9 million attributed to a net income of \$312,888 for the year. Gross Revenue was 3.4% or \$33,943 less than the previous year due mainly to a slightly lower loan interest income. Total Operating Expenses increased by an expected 4.9% or \$24,171 attributed to slight increases in payroll expenses and travel. The Bank realized a Net Income of \$456,165, however, the Board of Directors decided to set aside or reserve \$80,000 in Provision for Loan Losses as a result of the ALLL review and loan classification. This resulted in an adjusted Net Income of \$306,165 for the year. The table below summarizes key performance indicators compared to previous year (2015).

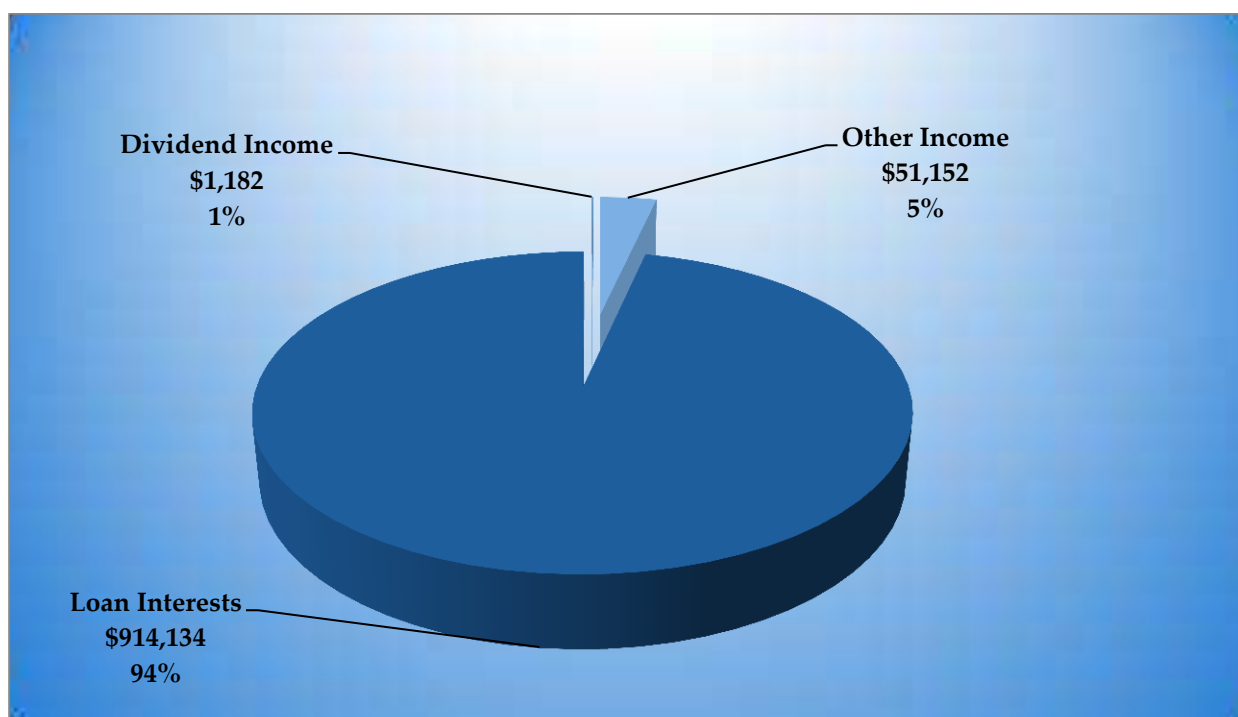
Selected Key Items		2016 Actual	2015 Actual	Variance (\$)	Variance (%)
Loans Receivable		11,709,661	10,575,723	1,133,938	10.7%
Stockholders' Equity		10,453,250	9,148,362	1,304,888	14.3%
Total Assets		13,645,691	11,706,871	1,938,820	16.6%
Retained Earnings		1,950,601	1,637,713	312,888	19.1%
Gross Revenue		966,468	1,000,411	-33,943	-3.4%
Total Operating Expenses[1]		516,916	492,745	24,171	4.9%
Provision for Loan Losses		80,000	150,000	-70,000	-46.7%
Net Income		312,888	306,165	6,723	2.2%

[1] Excludes Interest Expense and Provision for Loan Losses

Asset Mix

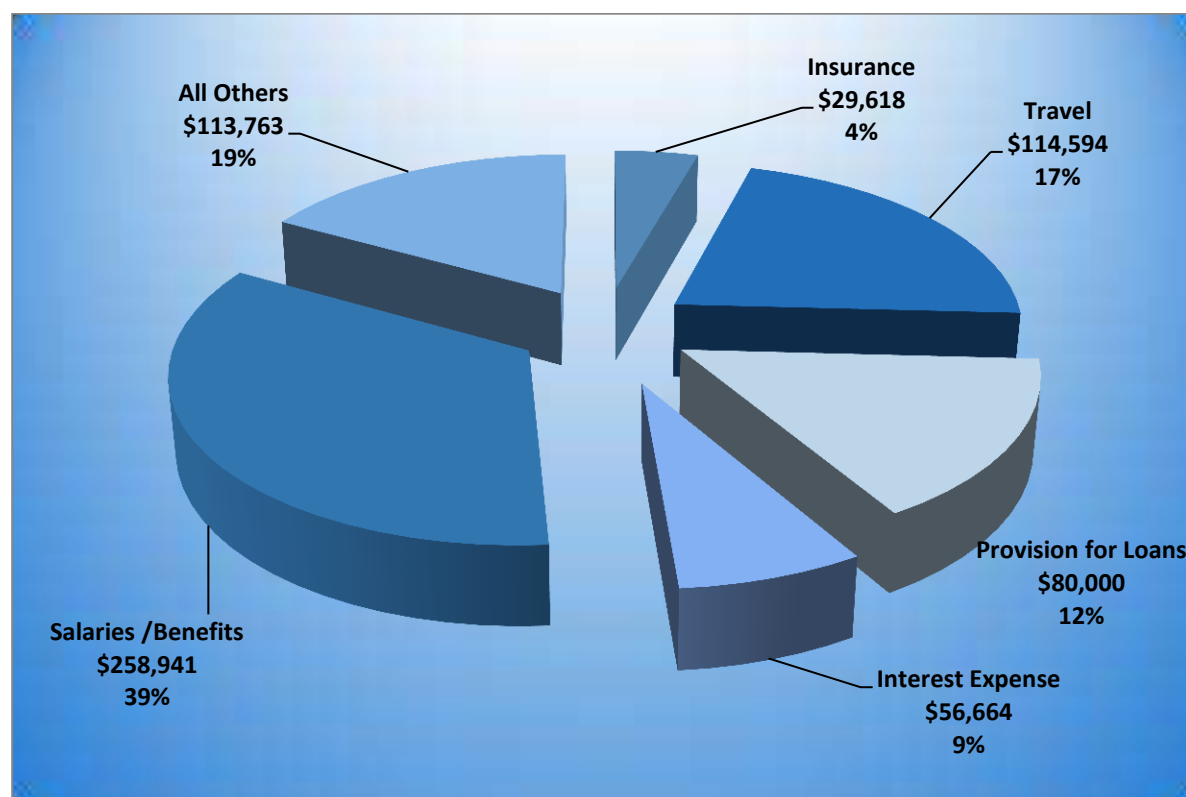


Revenue by Source

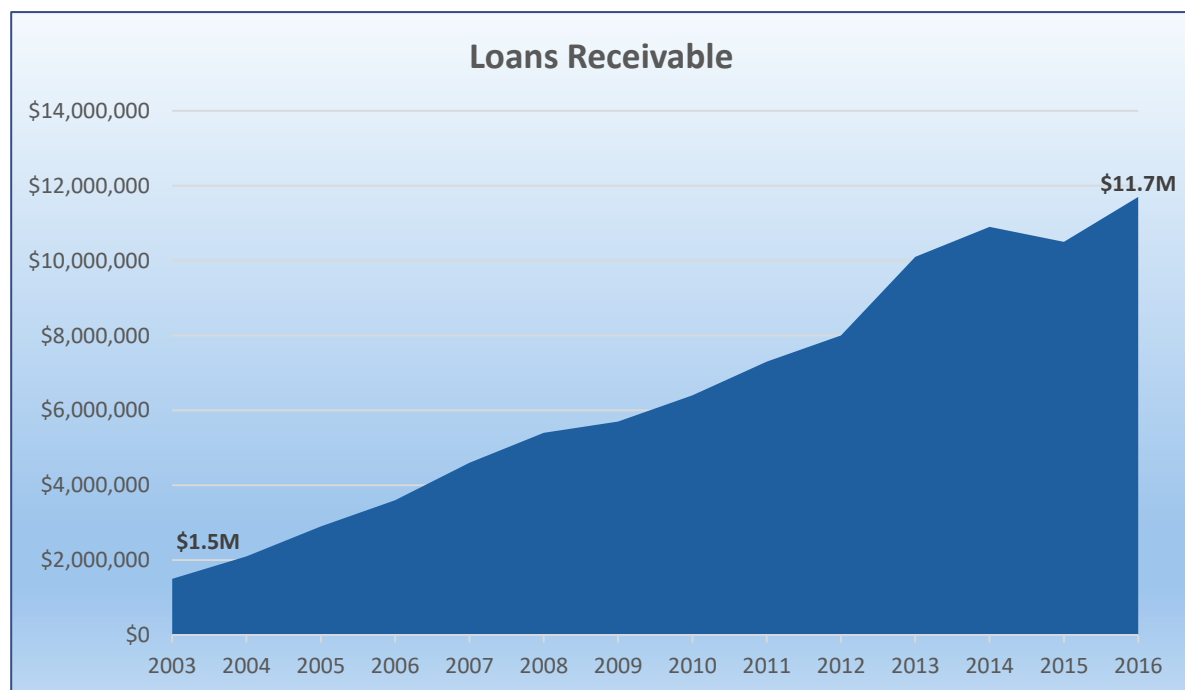
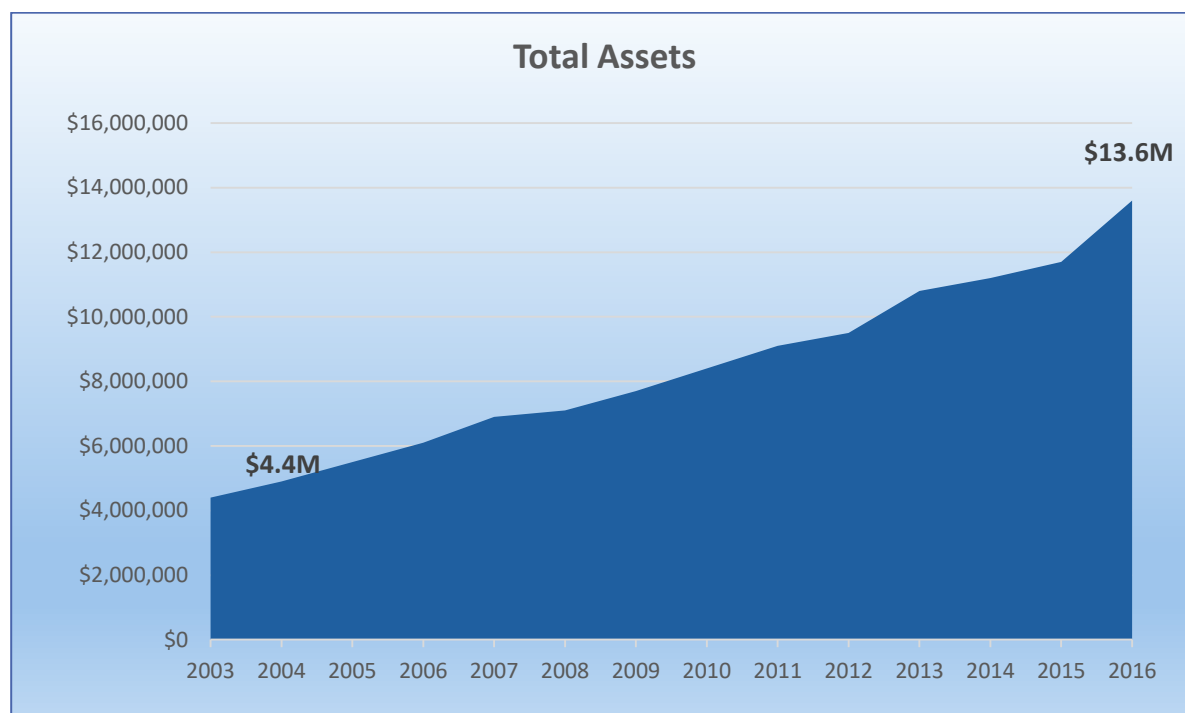


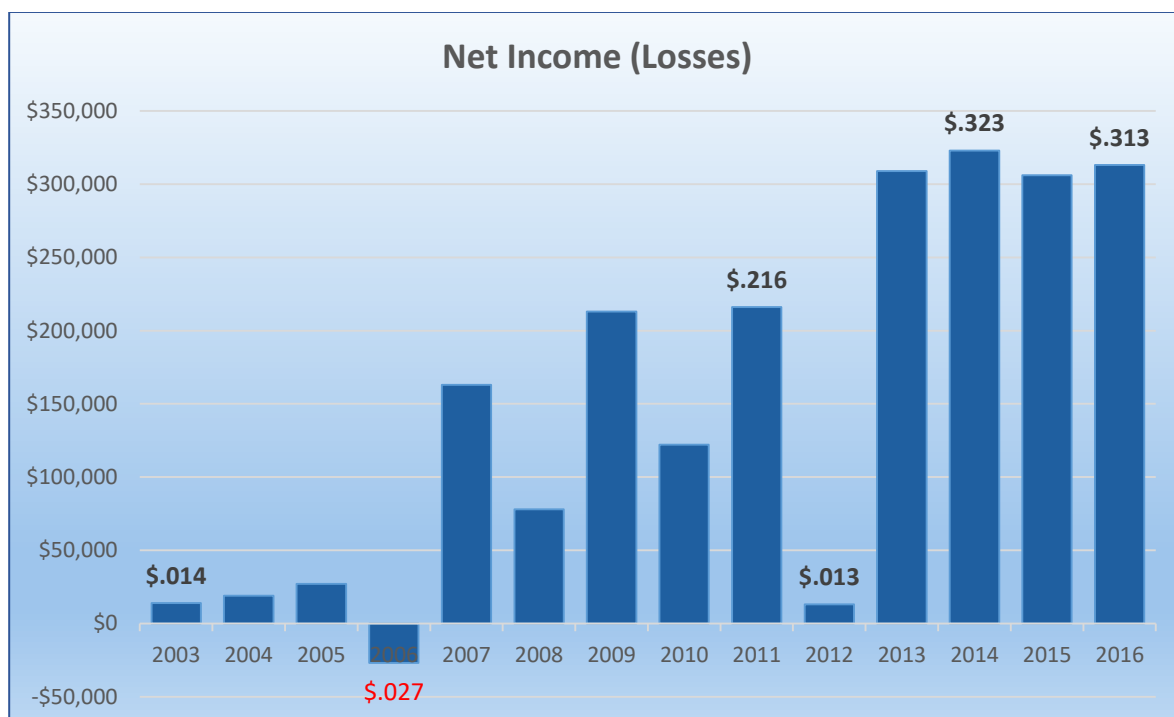
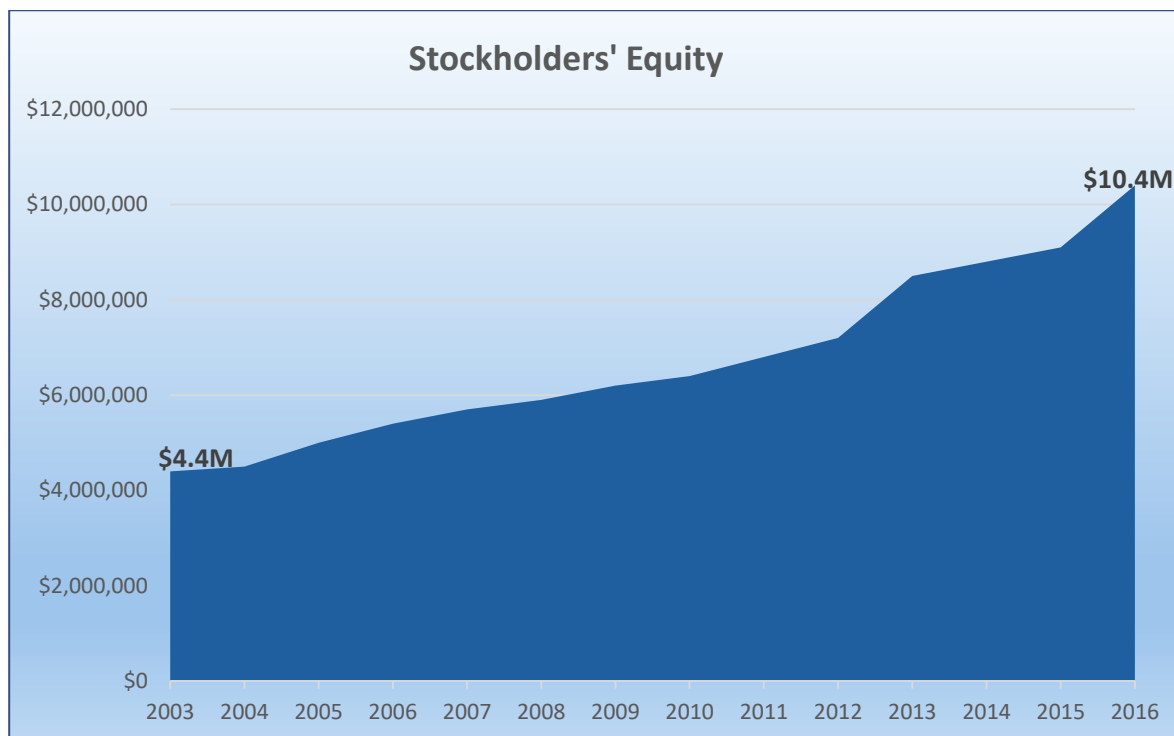
Major Expenses

The major expenses of the Bank are highlighted in the Chart below. The Bank's operating expenses reflects its corporate and operational structure. With a 16-member Board of Governors and an 8-member Board of Directors, and given the Bank's operational scope and structure, Travel and Communication expenses, for example, are high. The Provision for Loans is discretionary, based on the Board of Directors' quarterly review and classification of the Bank's loan portfolio. Based on such review, the Board decided to set aside or provision \$80,000 for 2016. Interest Expense in the amount of \$56,664 covered 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, 2003 – 2016







Selected Financial Ratios

Selected Ratios	2010	2011	2012	2013	2014	2015	2016
GROWTH							
Total Asset Growth	9%	8%	5%	14%	4%	4.2%	16.6%
Loan Growth	12%	15%	10%	25%	8%	-2.7%	10.7%
Long Term Debt Growth	35%	14%	0.2%	3%	2%	5.7%	25.1%
Net Worth Growth	3%	6%	6%	18%	4%	3.6%	14.2%
PROFITABILITY							
Return on Assets	1.5%	2.4%	0.13%	2.9%	2.9%	2.6%	2.3%
Return on Equity	1.9%	3.1%	0.18%	3.6%	3.7%	3.3%	3.0%
Net Margin	20%	30%	2%	30%	34%	32%	34%
LEVERAGE							
Net Worth	\$6.4M	\$6.8M	\$7.2M	\$8.5M	\$8.9M	\$9.1M	\$10.M
Debt to Worth	31%	33%	32%	28%	27%	28%	31%
Total Liabilities/Total Assets	24%	25%	25%	22%	21%	22%	23%
LIQUIDITY							
Working Capital	\$2.3M	\$2.0M	\$1.9M	\$1.3M	\$.9M	\$1.3M	\$2.3M
Current Ratio	3,444	2,660	425	279	127	186	268


Board Activities During the Year (2016)

A. Board of Governors

1. Held its annual meeting in April 2016 in Kosrae and took the following actions:
 - Received and reviewed the Bank's 2015 Annual Report and Audit Report.
 - Received for information the Bank's 2016 Budget and Goals.
 - Reviewed the Bank's updated Strategic Plan (for period 2014-2018).
 - Directed CEO and Board of Directors to conduct a comprehensive review of the Bank's Articles and Bylaws and make recommendations for improvement.
 - Reviewed 5 Resolutions, adopted 4 and deferred 1 (regarding associate members' voting rights).
 - Discussed and strategized efforts to increase bank capitalization.
 - Conducted annual review of President/CEO's performance.
 - Elected new officers as called for in the Bank's Articles (Governor Tony Ganngiyan as Chairman, Governor Reed Oliver as Vice Chairman, and Governor Swenny Ongidobel as Secretary).

B. Board of Directors

1. Held 3 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 Annual Report and Audit Report.

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3. Review and approved budget and goals for the ensuing year.
 4. Support management in efforts to secure additional capital and funding.
 5. Conducted annual review of the President/CEO annual performance and provided comments to the Board of Governors.



Pacific Islands Development Bank

Financial Statements and Independent Auditors' Report

Years Ended December 31, 2016 and 2015

PACIFIC ISLANDS DEVELOPMENT BANK

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED DECEMBER 31, 2016 AND 2015

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, 2016 and 2015, 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, 2016 and 2015, 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.

Deloitte & Touche LLP

April 11, 2017

PACIFIC ISLANDS DEVELOPMENT BANK

Statements of Condition
December 31, 2016 and 2015

<u>ASSETS</u>	<u>2016</u>	<u>2015</u>
Cash and cash equivalents	\$ 2,296,695	\$ 1,341,400
Loans receivable, net	11,106,544	10,036,481
Interest receivable, net of an allowance of \$70,000 at December 31, 2016	186,352	255,618
Property and equipment, net	<u>56,100</u>	<u>73,372</u>
	<u>\$ 13,645,691</u>	<u>\$ 11,706,871</u>
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
Liabilities:		
Other liabilities	\$ 25,236	\$ 25,896
Long-term debt	<u>3,167,205</u>	<u>2,532,613</u>
Total liabilities	<u>3,192,441</u>	<u>2,558,509</u>
Commitments		
Stockholders' equity:		
Capital stock	8,502,649	7,510,649
Retained earnings	<u>1,950,601</u>	<u>1,637,713</u>
Total stockholders' equity	<u>10,453,250</u>	<u>9,148,362</u>
	<u>\$ 13,645,691</u>	<u>\$ 11,706,871</u>

See accompanying notes to financial statements.

PACIFIC ISLANDS DEVELOPMENT BANKStatements of Income
Years Ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Loan interest income	\$ 914,134	\$ 965,463
Other interest and dividend income	<u>1,182</u>	<u>708</u>
	915,316	966,171
Provision for loan losses	<u>80,000</u>	<u>150,000</u>
	<u>835,316</u>	<u>816,171</u>
Operating expenses:		
Salaries and related expenses	258,941	239,991
Conference and travel	114,594	109,257
Insurance	29,618	30,899
Professional fees	22,238	19,594
Office rental	20,951	22,393
Depreciation	15,568	13,279
Board meetings	12,259	8,316
Communications	11,578	8,163
Office supplies	8,368	8,725
Business development and marketing	6,022	7,355
Automobile	3,326	4,154
Education and training	-	2,023
Miscellaneous	<u>13,453</u>	<u>18,596</u>
Total operating expenses	<u>516,916</u>	<u>492,745</u>
Operating income	<u>318,400</u>	<u>323,426</u>
Other income (expense):		
Interest expense	(56,664)	(51,501)
Other income	<u>51,152</u>	<u>34,240</u>
Total other expense, net	<u>(5,512)</u>	<u>(17,261)</u>
Net income	<u>\$ 312,888</u>	<u>\$ 306,165</u>

See accompanying notes to financial statements.

PACIFIC ISLANDS DEVELOPMENT BANK

Statements of Changes in Stockholders' Equity
Years Ended December 31, 2016 and 2015

	<u>Shares of Common Stock</u>	<u>Common Stock</u>	<u>Retained Earnings</u>	<u>Total</u>
Balance at December 31, 2014	7,500	\$ 7,500,649	\$ 1,331,548	\$ 8,832,197
Issuance of common stock	10	10,000	-	10,000
Net income	<u>-</u>	<u>-</u>	<u>306,165</u>	<u>306,165</u>
Balance at December 31, 2015	7,510	7,510,649	1,637,713	9,148,362
Issuance of common stock	992	992,000	-	992,000
Net income	<u>-</u>	<u>-</u>	<u>312,888</u>	<u>312,888</u>
Balance at December 31, 2016	<u>8,502</u>	<u>\$ 8,502,649</u>	<u>\$ 1,950,601</u>	<u>\$ 10,453,250</u>

See accompanying notes to financial statements.

PACIFIC ISLANDS DEVELOPMENT BANK

Statements of Cash Flows Years Ended December 31, 2016 and 2015

	<u>2015</u>	<u>2015</u>
Cash flows from operating activities:		
Net income	\$ 312,888	\$ 306,165
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	15,568	13,279
Provision for loan loss	80,000	150,000
Decrease (increase) in interest receivable	69,266	(22,931)
(Decrease) increase in other liabilities	<u>(660)</u>	<u>18,620</u>
Net cash provided by operating activities	<u>477,062</u>	<u>465,133</u>
Cash flows from investing activities:		
Loan originations and repayments, net	(1,150,063)	125,247
Proceeds from sale of property and equipment	8,500	-
Additions to property and equipment	<u>(6,796)</u>	<u>(49,649)</u>
Net cash (used in) provided by investing activities	<u>(1,148,359)</u>	<u>75,598</u>
Cash flows from financing activities:		
Proceeds from long-term debt	762,571	238,000
Repayment on long-term debt	(127,979)	(100,832)
Proceeds from issuance of capital stock	<u>992,000</u>	<u>10,000</u>
Net cash provided by financing activities	<u>1,626,592</u>	<u>147,168</u>
Net change in cash and cash equivalents	955,295	687,899
Cash and cash equivalents at beginning of year	<u>1,341,400</u>	<u>653,501</u>
Cash and cash equivalents at end of year	<u>\$ 2,296,695</u>	<u>\$ 1,341,400</u>
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest	<u>\$ 56,664</u>	<u>\$ 34,322</u>

See accompanying notes to financial statements.

PACIFIC ISLANDS DEVELOPMENT BANK

Notes to Financial Statements
December 31, 2016 and 2015

(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 or lease agreement and when doubt about repayment is resolved. At December 31, 2016 and 2015, the Bank has placed one loan in the amount of \$289,091 on non-accrual status.

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, 2016 and 2015

(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, 2016 and 2015, 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 balance sheet 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. Leasehold improvements are depreciated 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, 2016 and 2015

(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. The Bank does not have any significant concentrations in any one industry or customer.

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, 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 April 11, 2017, 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, 2016.

(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, 2016 and 2015

(2) Loans Receivable, Continued

A summary of the balances of loans at December 31, 2016 and 2015 follows:

	<u>2016</u>	<u>2015</u>
Commercial – PIDB direct loan program	\$ 6,199,994	\$ 5,575,723
Residential loans	1,905,042	1,730,947
Commercial – USDA Intermediary Relending Program (IRP)	1,430,359	1,597,706
Consumer	1,341,639	1,070,125
Commercial – FSMDB import/export	<u>832,627</u>	<u>601,426</u>
Gross loans	11,709,661	10,575,927
Less: allowance for loan losses	<u>(603,117)</u>	<u>(539,446)</u>
Net loans	\$ <u>11,106,544</u>	\$ <u>10,036,481</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, 2016 and 2015 was \$384,000 and \$396,000, respectively.

(3) Allowance for Loan Losses

A summary of the changes in the allowance for loan losses for the years ended December 31, 2016 and 2015, follows

	<u>2016</u>	<u>2015</u>
Balance at beginning of year	\$ 539,446	\$ 603,539
Loans charged off	(26,266)	(222,816)
Recoveries of loans previously charged off	9,937	8,723
Provision for loan losses	<u>80,000</u>	<u>150,000</u>
Balance at end of year	\$ <u>603,117</u>	\$ <u>539,446</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, 2016 and 2015

(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, 2016 and 2015:

	<u>Pass</u>	<u>Special mention</u>	<u>Sub- standard</u>	<u>Doubtful</u>	<u>Total</u>
<u>2016</u>					
PIDB direct	\$ 5,251,941	\$ 146,131	\$ 283,019	\$ 518,903	\$ 6,199,994
Residential	1,685,296	219,746	-	-	1,905,042
IRP	1,065,994	71,210	4,064	289,091	1,430,359
Consumer	1,188,295	82,529	56,231	14,584	1,341,639
Import/export	<u>748,532</u>	<u>9,188</u>	<u>-</u>	<u>74,907</u>	<u>832,627</u>
Total	\$ <u>9,940,058</u>	\$ <u>528,804</u>	\$ <u>343,314</u>	\$ <u>897,485</u>	\$ <u>11,709,661</u>
<u>2015</u>					
PIDB direct	\$ 4,545,776	\$ 526,530	\$ 52,182	\$ 451,235	\$ 5,575,723
Residential	1,519,599	211,348	-	-	1,730,947
IRP	1,169,153	106,886	32,576	289,091	1,597,706
Consumer	897,910	112,120	49,353	10,742	1,070,125
Import/export	<u>467,940</u>	<u>25,677</u>	<u>32,902</u>	<u>74,907</u>	<u>601,426</u>
Total	\$ <u>8,600,378</u>	\$ <u>982,561</u>	\$ <u>167,013</u>	\$ <u>825,975</u>	\$ <u>10,575,927</u>

PACIFIC ISLANDS DEVELOPMENT BANK

Notes to Financial Statements
December 31, 2016 and 2015

(3) Allowance for Loan Losses, Continued

The following presents by class, an aging analysis of the Bank's loan portfolio as of December 31, 2016 and 2015:

	<u>Current</u>	30 – 59 Days <u>Past Due</u>	60 – 89 Days <u>Past Due</u>	Past Due 90 Days or More	<u>Total</u>
<u>2016</u>					
PIDB direct	\$ 5,577,998	\$ 103,093	\$ -	\$ 518,903	\$ 6,199,994
Residential	1,905,042	-	-	-	1,905,042
IRP	1,037,914	103,354	-	289,091	1,430,359
Consumer	1,289,152	24,851	2,775	24,861	1,341,639
Import/export	<u>757,720</u>	<u>-</u>	<u>-</u>	<u>74,907</u>	<u>832,627</u>
Total	\$ <u>10,567,826</u>	\$ <u>231,298</u>	\$ <u>2,775</u>	\$ <u>907,762</u>	\$ <u>11,709,661</u>
<u>2015</u>					
PIDB direct	\$ 5,044,746	\$ 6,551	\$ 63,915	\$ 460,511	\$ 5,575,723
Residential	1,711,434	19,513	-	-	1,730,947
IRP	1,191,963	60,469	-	345,274	1,597,706
Consumer	957,633	76,322	8,835	27,335	1,070,125
Import/export	<u>355,216</u>	<u>138,402</u>	<u>-</u>	<u>107,808</u>	<u>601,426</u>
Total	\$ <u>9,260,992</u>	\$ <u>301,257</u>	\$ <u>72,750</u>	\$ <u>940,928</u>	\$ <u>10,575,927</u>

At December 31, 2016 and 2015, impaired loans of \$897,485 and \$825,975, respectively, represent loans classified as doubtful, with total recorded allowances of \$448,742 and \$412,988, respectively.

(4) Property and Equipment

A summary of property and equipment as of December 31, 2016 and 2015, is as follows:

<u>Description</u>	<u>Estimated Useful Lives</u>	<u>2016</u>	<u>2015</u>
Computer and software	5 years	\$ 63,700	\$ 58,462
Vehicles	5 years	65,014	73,229
Leasehold improvements	3 years	31,041	31,041
Office furniture and equipment	10 years	<u>25,097</u>	<u>23,825</u>
		184,852	186,557
Less accumulated depreciation		<u>(128,752)</u>	<u>(113,185)</u>
		\$ <u>56,100</u>	\$ <u>73,372</u>

PACIFIC ISLANDS DEVELOPMENT BANK

Notes to Financial Statements
December 31, 2016 and 2015

(5) Long-Term Debt

Long-term debt as of December 31, 2016 and 2015, consists of the following:

	<u>2016</u>	<u>2015</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.	\$ 329,339	\$ 347,093
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.	570,903	598,956
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.	624,142	649,991
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.	271,386	271,386
A \$500,000 loan with the FSM Development Bank (FSMDB) on September 16, 2010. Interest fixed at 4% per annum. Interest only payments for first three years, thereafter 40 equal quarterly installments of \$15,228.	371,435	427,758
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 40 equal quarterly installments of \$30,456.	<u>1,000,000</u>	<u>237,429</u>
Total	\$ <u>3,167,205</u>	\$ <u>2,532,613</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, 2016, future maturities of long-term debt are as follows:

Year ending December 31,

2017	\$ 124,435
2018	195,809
2019	215,785
2020	199,561
2021	228,746
Thereafter	<u>2,202,869</u>
	\$ <u>3,167,205</u>

PACIFIC ISLANDS DEVELOPMENT BANK

Notes to Financial Statements
December 31, 2016 and 2015

(6) Stockholders' Equity

Under the "Articles of Agreement Establishing The Pacific Islands Development Bank" (the Articles), each member is to contribute \$1,000,000 for the purchase of shares in the Bank. If all eligible governments participate, equity contributions of \$10,000,000 would result. As of December 31, 2016 and 2015, the Bank has received \$8,502,649 and \$7,510,649, respectively, of equity contributions. Authorized capital stock is 18,000 shares of \$1,000 par value. As of December 31, 2016 and 2015, 8,502 and 7,510 shares, respectively, have been issued and are outstanding.

This under-capitalization has delayed the Bank in expanding its operating activities. In order for the Bank to engage in operations of the size contemplated, significant capital infusions are required from existing and prospective members.

(7) Leases

The Bank operates from a leased office space with monthly lease payments of \$1,682, increased to \$1,732 effective July 1, 2015, plus allocation of utility charges, expiring on June 30, 2018. Future commitments under the lease as of December 31, 2016 are \$20,784 and \$10,392 for the years ending December 31, 2017, and 2018, respectively.

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, 2016 and 2015, the Bank contributed \$11,661 and \$16,449, respectively, to the Plan.