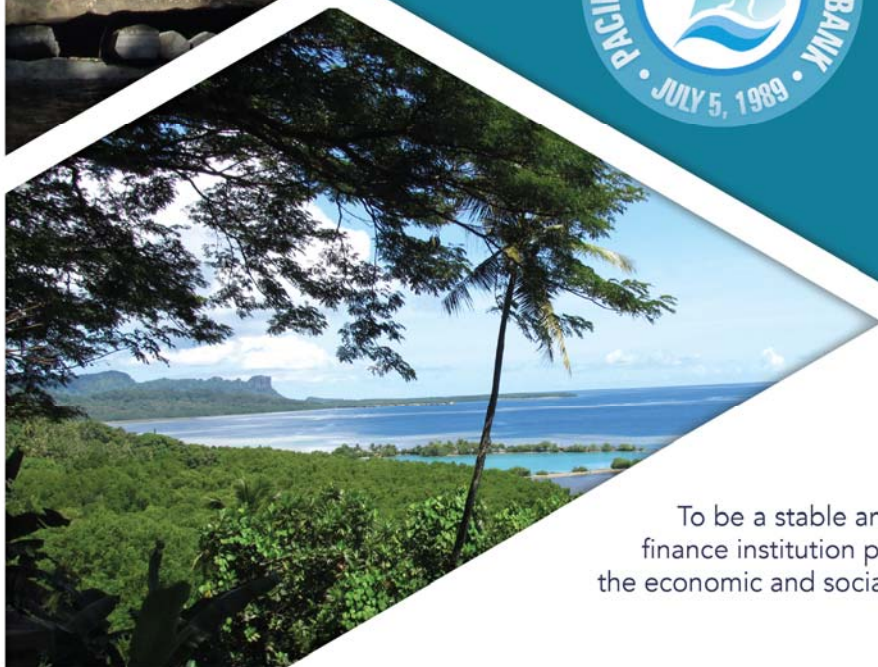


2017

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. 2017 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 (2016).....	12
Asset Mix	13
Revenue by Source	13
Major Expenses	14
Financial Summary, 2004 – 2017	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

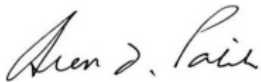
March 31, 2018

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, 2017.

Respectfully,



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

Message from the President & CEO

2017 was another great year for the Bank, surpassing the record performance set in 2016. The Yap State Business Development Loan Program was implemented with an initial disbursement of \$750,000 to PIDB. The total funding committed to support this program is \$3 million. In 2017, Kwajalein Atoll Local Government became an associate member with an initial capital payment of \$500,000. Its member to the Board of Directors has been appointed and the Bank began processing loan applications from Kwajalein/Ebeye with priority emphasis on residential housing/home loans. Further, Pohnpei State Government infused an additional \$300,000 in equity capital, increasing its total paid-in capital to \$1.3 million. Last but not least, Chuuk State leaders informed the Bank that \$25,000 for additional capital payment to PIDB was appropriated during the year. Efforts to secure additional capital infusion from Palau, CNMI, Kosrae and Guam are on-going. We convey our sincere gratitude and appreciation to Yap State, Pohnpei State, and Chuuk State for infusing additional capital into the Bank and we welcome Kwajalein Atoll to our PIDB family.

The year in review, 2017, marked the fourth year under our current Strategic Plan, covering the period 2014 to 2018. In the past four years, we remained focused on growth related initiatives and strategies outlined in the Strategic Plan. Resource mobilization and capacity enhancement, especially capitalization and funding, remains one of the Bank's greatest challenges and impediments to our future progress. We therefore solicit the assistance of our shareholders and Board members in our efforts to further capitalize the bank.

With respect to bank operation, I am pleased to report that the Bank once again did very well in 2017. We once again realized sustained and quality growth in our balance sheet and we registered record earnings and profitability. Some of the key accomplishments and financial highlights of the period under review are as follows:

- *Total Assets increased by 13.2% or \$1.7 million to \$15.4 million*
- *Capital Stock increased by 9.4% or \$800,000 to \$9.3 million*
- *Retained Earnings increased by 57.4% or \$1.1 million to \$3.0 million*
- *Total Stockholders' Equity increased by 18.3% or \$1.9 million to \$12.3 million*
- *Total Operating Expenses was reduced by 8.3% or \$43,137 to \$473,779*
- *Net Income increased by 258% or \$807,264 to \$1.1 million, representing a record Return on Asset of 7.2% and Return on Equity of 9.1%*
- *Achieved "unqualified" audit opinion with no questioned costs and loan documentation issues.*

In 2017, the Board of Governors conducted a comprehensive review of the Bank's Articles of Agreement and Bylaws and approved a number of amendments. One of the key amendments relates to Associate Membership requirements and voting structure and privilege, granting an associate member the privilege to appoint one non-voting member to the Board of Directors.

The bank has already charted its course and its journey has begun. Although PIDB's journey has been an exciting one by far, much challenges and uncertainties remain over the horizon. To stay the course, we must continue to use our Strategic Plan as our guide. And as we approach the last year (2018) of our planned period, the Bank's main goals and objectives remain: (1) to increase the bank's resource base and capacity, (2) to effectively manage credit risks, (3) to manage and increase return on securities investment, (4) to diversify and improve delivery of products and services to our clientele, (5) to manage our margins by increasing revenue and controlling expenses; and (6) to ensure a prudent operation complying with applicable laws and regulations and internal bank policies and procedures. Let us rededicate ourselves to achieving these goals, thereby contributing to the mission of the Bank and ultimately improving the life and livelihood of our people.

Finally, we thank our Shareholders for their unwavering support and commitment. We also acknowledge and convey our gratitude and appreciation to the members of the Board of Governors, Board of Directors, and our staff for their diligence, dedication, and contributions without which the remarkable achievements in 2017 would not have been possible.



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

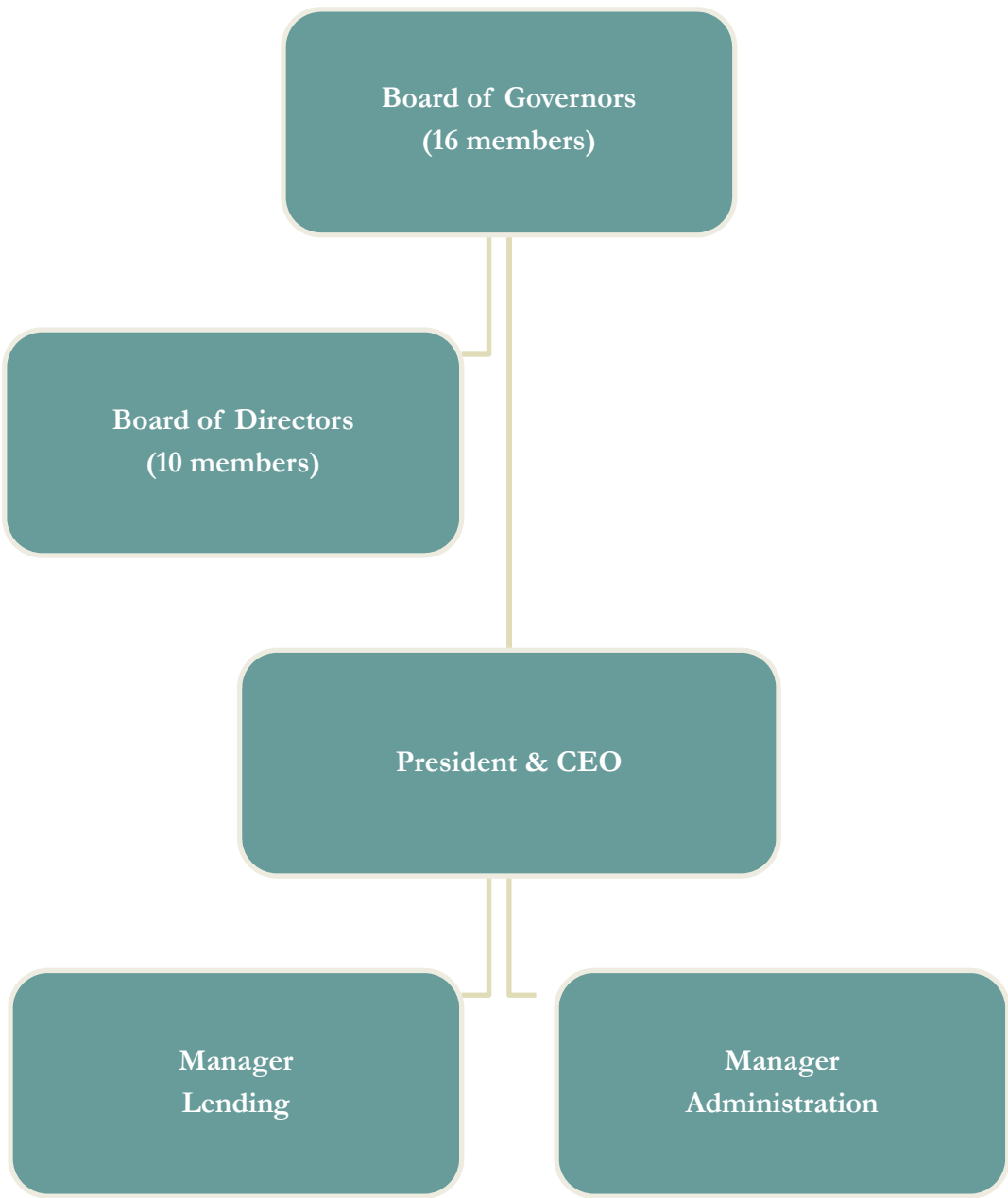
"To contribute to the acceleration of the process of economic and social development of member countries and States, individually and collectively, and to promote economic cooperation among them."

Shareholders & Paid in Capital

Shareholders	2017	
	# 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	1,300	1,300,000
Yap	1,439	1,438,866
Kwajalein Atoll	500	500,000
Total	9,302	\$9,302,649

The initial capital each member pledged and agreed to pay is \$1 million. For the period under review, Kwajalein Atoll became an associate member with an initial capital infusion of \$500,000. Pohnpei State also made another capital infusion of \$300,000 in 2017.

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, Secretary Congressman
Guam:	Edward Calvo Governor	Vacant
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, Vice Chairman Delegate, House of Delegates, OEK
Pohnpei:	Reed Oliver, Chairman Lt. Governor	Carlos Villazon Budget Officer
Yap:	Tony Ganngiyan 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 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
Palokoa George Accountant, Dept. of Admin. Kosrae State Govt.	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. Minister of R&C RMI National Govt.	Anjojo Kabua III Executive Director Kwajalein Atoll Dev. Authority
Management		
Aren Palik President/CEO Chairman		

II. 2017 Operational Summary

A. Loan Report

Approved Loans

Loan Type	2017 No. of Loans	Amount	2016 No. of Loans	Amount
Commercial Loans				
Agriculture	0	0	0	0
Fisheries	2	29,037	1	100,000
Tourism	4	737,066	1	9,000
Manufacturing	0	0	1	100,000
Services	3	146,852	6	1,010,699
Commercial	3	485,014	2	400,000
Sub Total	12	1,397,969	11	1,619,699
Residential Home Loans	5	830,000	8	523,109
Consumer Loans	21	157,156	79	794,325
Total	38	2,385,125	98	2,937,133

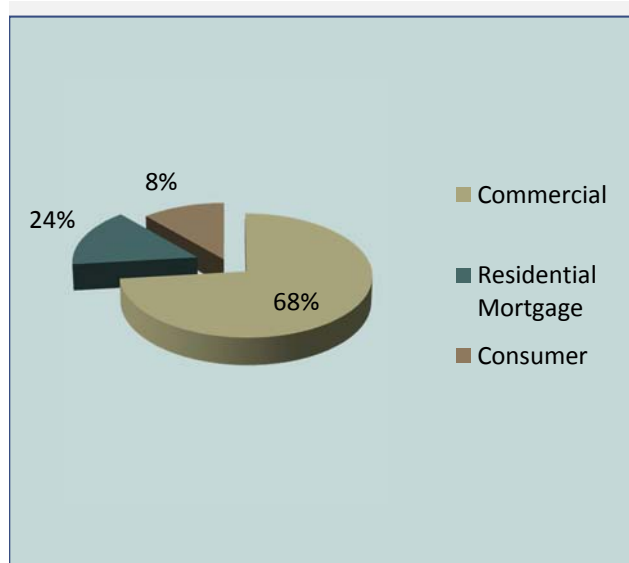
Outstanding Loans by Sector

Loan Type	2017 #	Amount \$	2016 #	Amount \$
Commercial Loans				
Agriculture	3	627,798	3	627,798
Fisheries	3	152,953	3	152,953
Tourism	12	935,006	7	935,006
Manufacturing	0	265,148	1	265,148
Services	42	2,802,532	46	2,802,532
Commercial	26	3,255,590	24	3,255,590
Sub Total	86	8,046,548	84	8,039,027
Residential Home Loans	37	2,873,559	34	2,329,195
Consumer Loans	163	1,000,070	185	1,341,439
Total	286	11,919,509	387	\$11,709,661

Loan Distribution by Shareholder

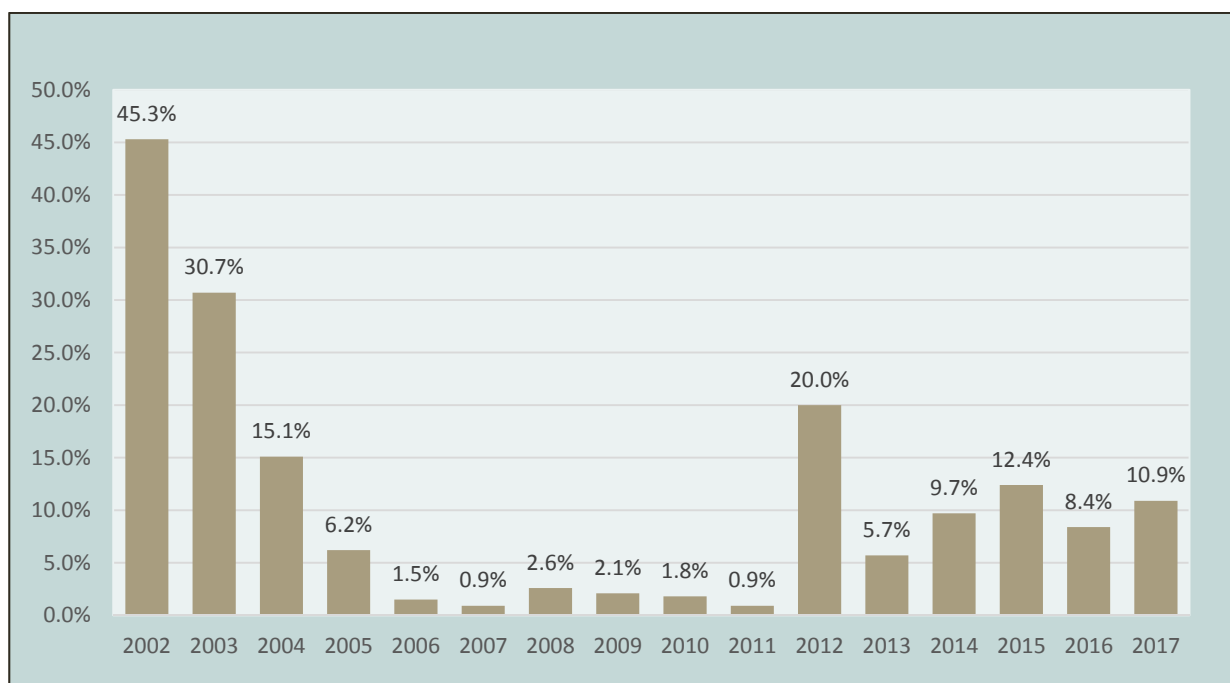
Shareholder	Commercial		Consumer		Housing		Total	
	#	Value	#	Value	#	Value	#	Value
Guam	6	629,936	50	254,808	2	185,117	58	1,069,861
Palau	6	950,630	4	40,264	1	75,808	11	1,066,702
Pohnpei	3	112,733	8	88,794	4	165,360	15	366,887
Yap	17	2,008,629	61	357,524	5	330,281	83	2,695,766
Kosrae	29	767,889	30	167,383	12	284,342	71	1,219,614
CNMI	4	1,139,139	6	35,586	3	293,303	13	1,468,028
Chuuk	1	38,108	0	0	0	0	1	38,108
RMI	13	2,061,277	4	55,710	6	1,123,214	23	3,240,201
KADA	0	0	0	0	0	0	0	0
FSMDB/Export	7	338,207	0	0	4	416,135	11	754,342
Total	86	8,046,548	163	1,000,070	37	2,872,891	286	11,919,509

Loan Mix

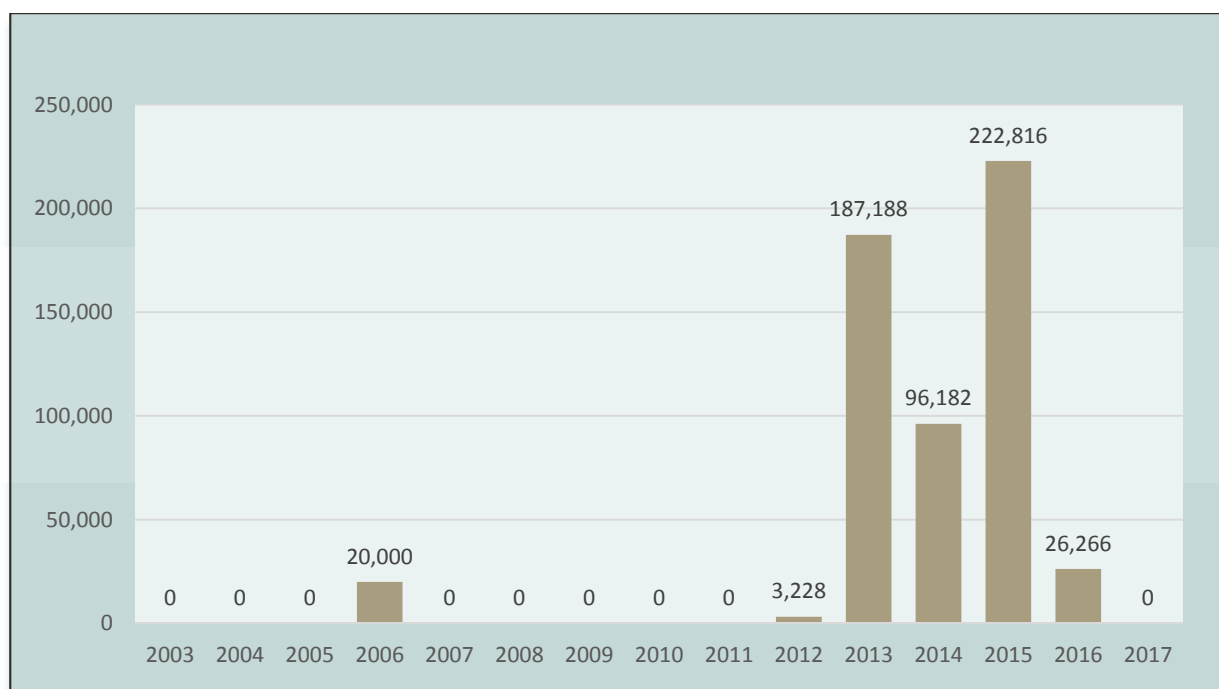


At 12/31/17, 68% or \$8.0 million of total loans was in Commercial Loans; 24% or \$2.8 million in Residential Home Loans; and 8% or \$1.0 million in Consumer Loans. The Bank's core lending is in Commercial loans, consistent with its core mission and purpose. For the period under review, average Consumer Loan per borrower is \$6,135; average Residential Home Loans is \$77,645; and average Commercial loan per borrower is \$93,565.

Loan Delinquency



Loan Charge Off



B. Financial Report

Performance Against Previous Year (2016)

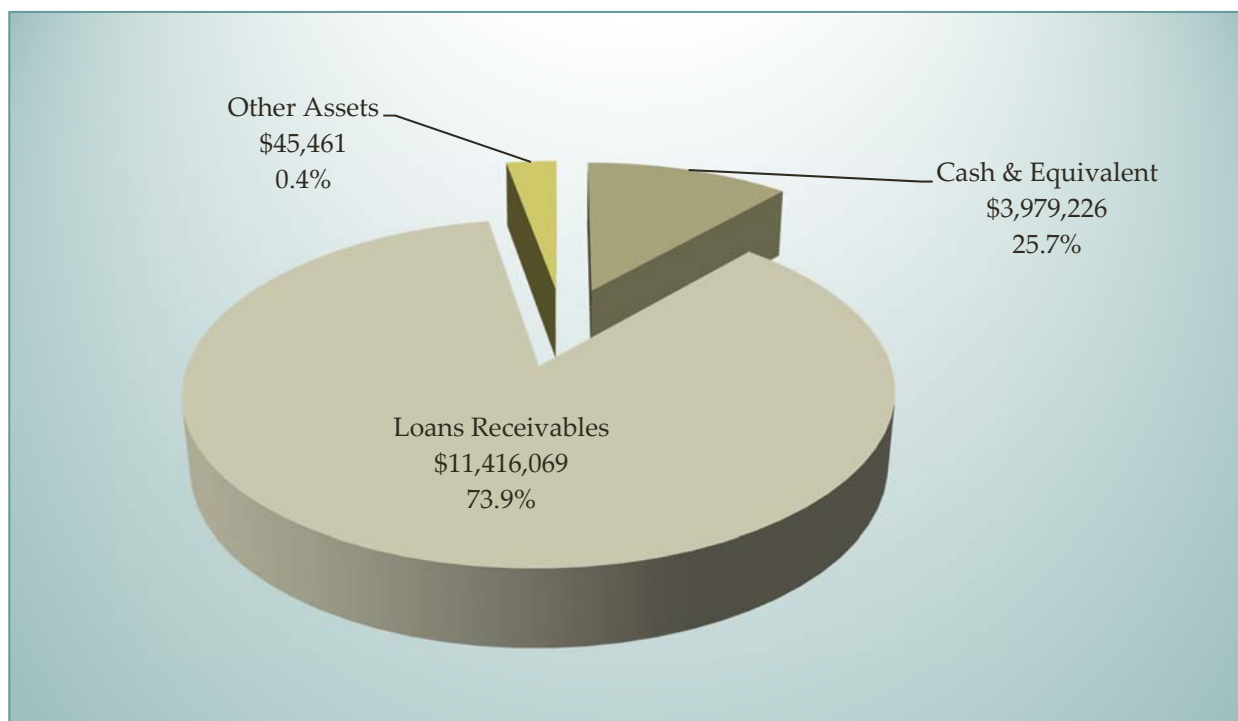
For the period under review, Loans Receivable increased by a mere 1.8% to \$11.9 million. In 2016, three large commercial loans were paid off by other banks resulting in significant decline in loan balances. Stockholders' Equity grew by 18.3% or \$1.9 million to \$12.3 million due primarily to improvement in the Bank's Retained Earnings and additional equity capital infusion from Pohnpei State and initial payment from Kwajalein Atoll Development Authority. Total Assets also saw a significant increase of 13.1% or \$1.7 million to \$15.4 million attributed to additional capital infusion and initial disbursement of \$750,000 by Yap State Government to fund the business development program. Retained Earnings grew by 57.4% to \$3.0 million attributed to a net income of \$379,456 for the year and \$750,000 from Yap State which was classified under Retained Earnings as suggested by the external auditor. Gross Revenue increased by \$111,409 or 11.5% due to higher loan interest income. Total Operating Expenses decreased by \$43,137 or 8.3% as a result of prudent management of expenses. In 2017, the bank also set aside \$68,000 in Provision for Loan Losses and \$82,395 Provision for Interest Receivable as a result of the ALLL review and loan classification and grading. Netting expenses from revenue, the Bank realized a Net Income of \$1,120,154, significantly higher than the previous year. This is attributed to the \$750,000 received from Yap State which was booked as a restricted contribution. Due to the restrictions associated with the program, contributions received are included as part of appropriated retained earnings. The Table below compares the bank's performance in 2017 against the previous year (2016) in selected key areas.

Selected Key Items	2017 Actual	2016 Actual	Variance (\$)	Variance (%)
Loans Receivable	11,920,177	11,709,661	210,516	1.8%
Stocholders' Equity	12,373,404	10,453,250	1,920,154	18.4%
Total Assets	15,440,756	13,645,691	1,795,065	13.2%
Retained Earnings	3,070,755	1,950,601	1,120,154	57.4%
Gross Revenue	1,124,988	966,468	158,520	16.4%
Total Operating Expenses (1)	473,779	516,916	(43,137)	-8.3%
Provision for Loan Losses	150,395	80,000	70,395	88.0%
Net Income (2)	1,120,154	312,888	807,266	258.0%

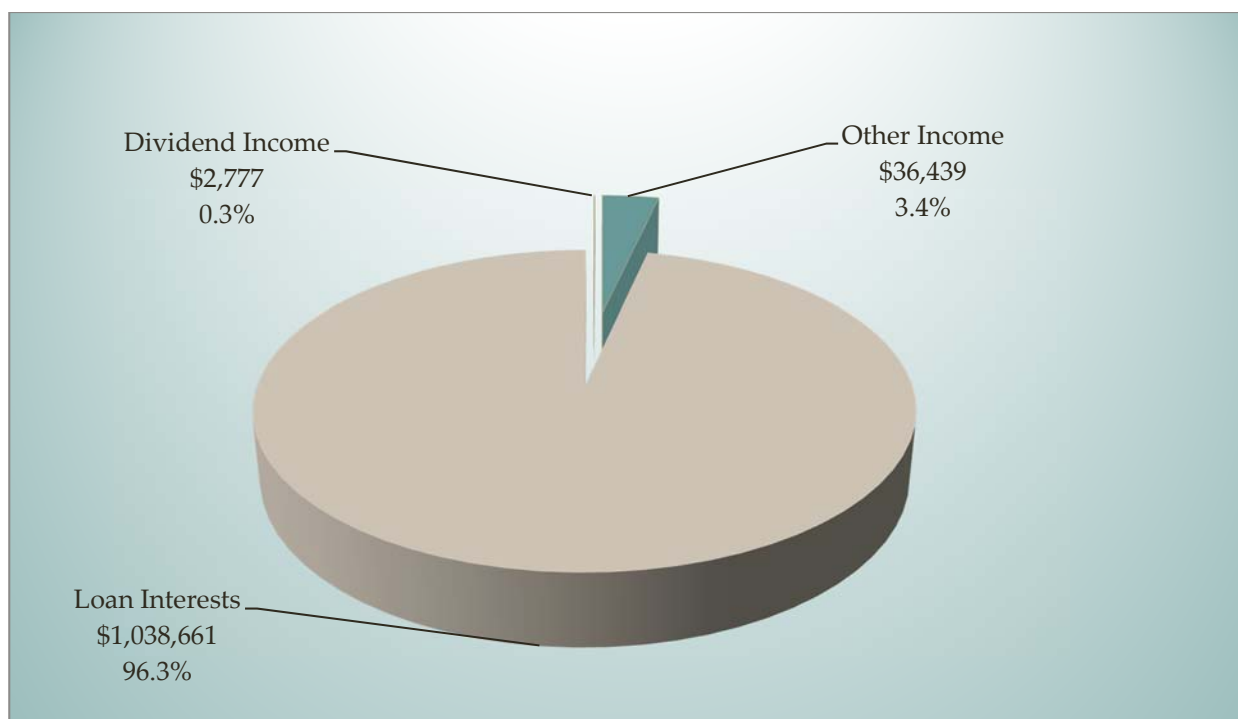
(1) Excludes provision for loan losses and interest expense

(2) Includes \$750,000 funds infused by Yap State govt. for business loan program

Asset Mix

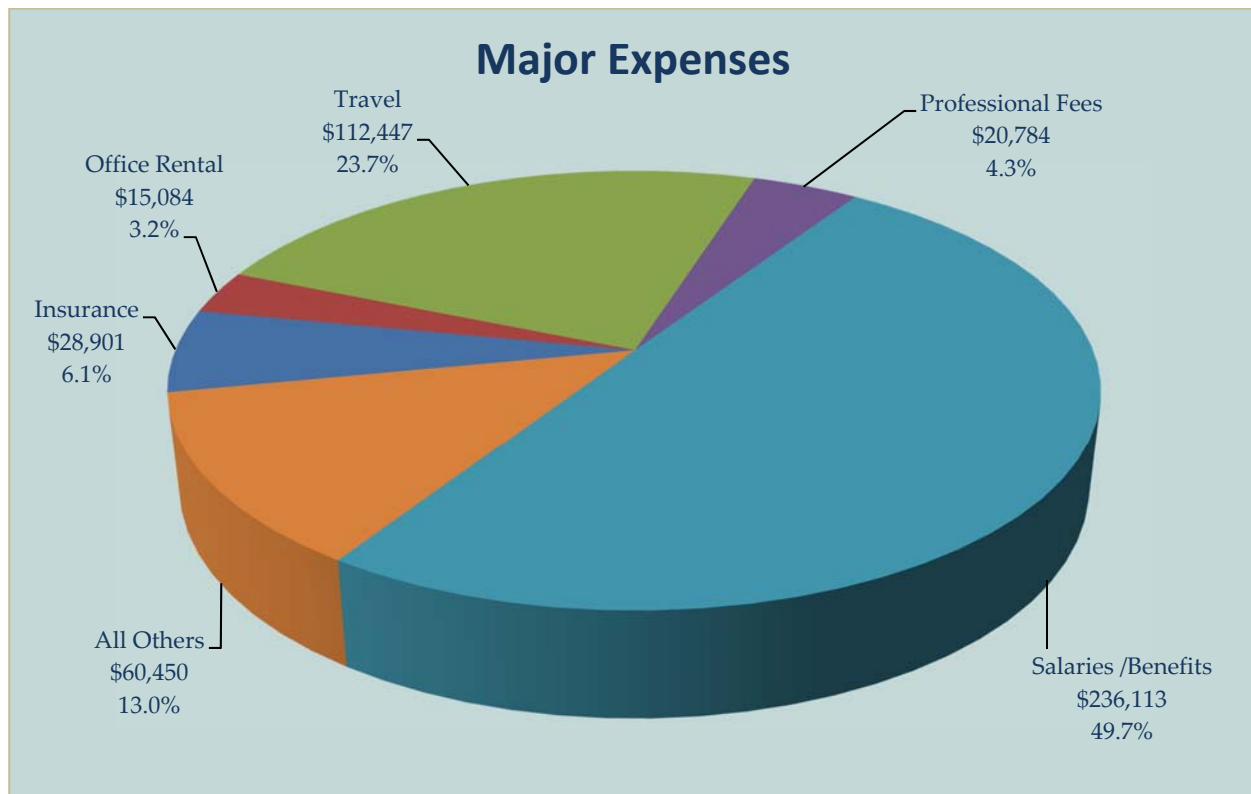


Revenue by Source

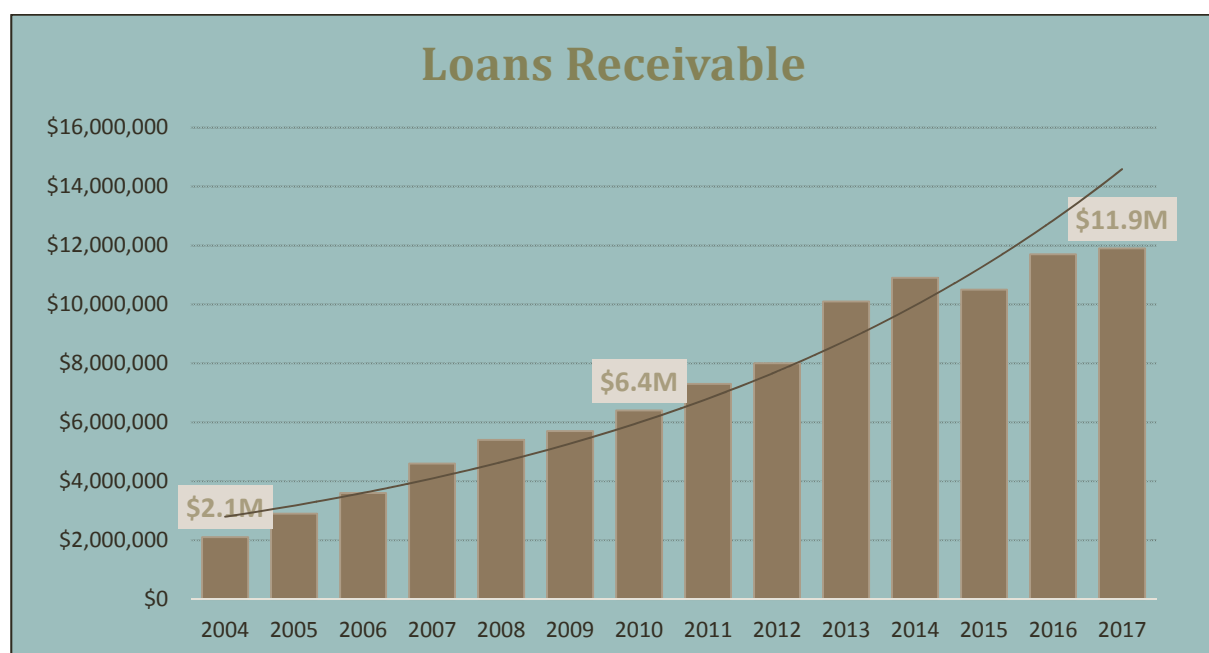


Major Expenses

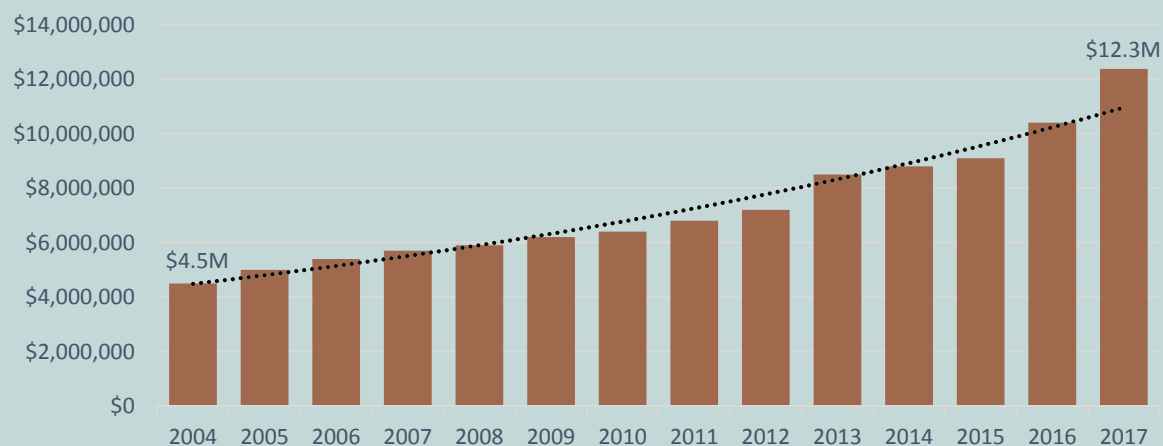
The Bank's operating expenses reflect its corporate and operational structure with a 16-member Board of Governors and a 10-member Board of Directors. The Bank's corporate office is currently in Guam with no branch offices yet. As such, Travel and Communication expenses, for example, are higher. The Provision 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 \$150,395 for 2017. Interest Expense in the amount of \$83,549 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.



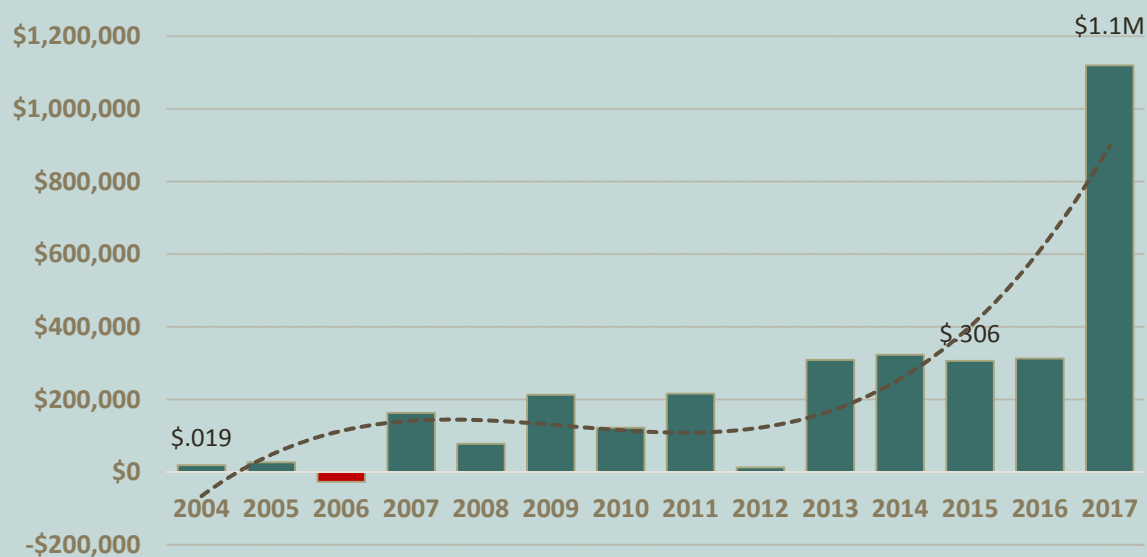
Financial Summary, 2004 – 2017

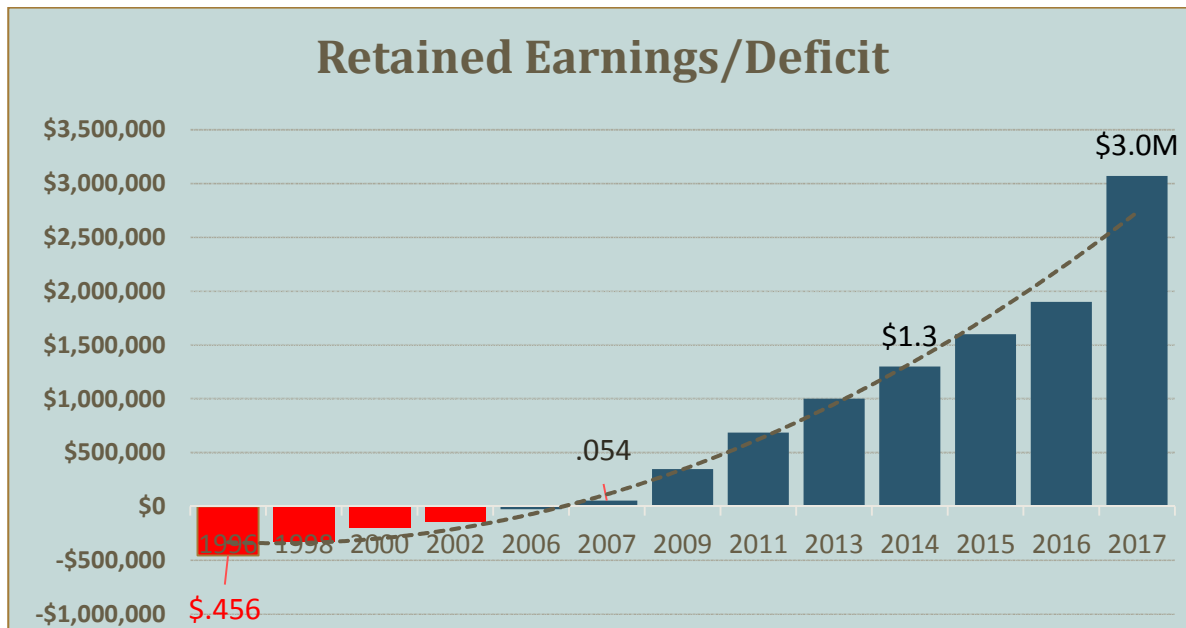


Stockholders' Equity



Net Income





Selected Financial Ratios

Selected Ratios	2011	2012	2013	2014	2015	2016	2017
GROWTH							
Total Asset Growth	8%	5%	14%	4%	4.2%	16.6%	13.2%
Loan Growth	15%	10%	25%	8%	-2.7%	10.7%	1.8%
Long Term Debt	14%	0.2%	3%	2%	5.7%	25.1%	-3.9%
Net Worth Growth	6%	6%	18%	4%	3.6%	14.2%	18.4%
PROFITABILITY							
Return on Assets	2.4%	0.13%	2.9%	2.9%	2.6%	2.3%	7.2%
Return on Equity	3.1%	0.18%	3.6%	3.7%	3.3%	3.0%	9.1%
Net Margin	30%	2%	30%	34%	32%	34%	107%
LEVERAGE							
Net Worth	6.8M	7.2M	8.5M	8.9M	9.1M	10.4M	12.3M
Debt to Worth	33%	32%	28%	27%	28%	31%	25%
Total Liabilities/Total Assets	25%	25%	22%	21%	22%	23%	20%
LIQUIDITY							
Working Capital	2.0M	\$1.9M	\$1.3M	\$0.9M	\$1.3M	\$2.3M	\$3.9M
Current Ratio	2,660	425	279	127	186	268	312

Board Activities During the Year (2017)

A. Board of Governors

1. The Board of Governors met in Saipan in April 2017 and took the following actions:
 - Received and reviewed the Bank's 2016 Annual Report and Audit Report.
 - Received the Bank's 2017 Budget and Goals for information.
 - Conducted a comprehensive review of the Bank's Articles of Agreement and Bylaws and approved changes, chief among which is the voting privileges of Associate members.
 - Approved Kwajalein Atoll Development Authority as an associate member.
 - Conducted the annual review of President/CEO's performance.
 - Reorganized and elected the following new officers: Governor Reed Oliver as Chairman, Governor Swenny Ongidobel as Vice Chairman, and Governor Joseph Guerrero 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 Annual Report and Audit Report.
3. Reviewed and approved budget and goals for the ensuing year.
4. Monitor and assist all efforts to secure additional capital and funding with quarterly review and update.
5. 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, 2017 and 2016

PACIFIC ISLANDS DEVELOPMENT BANK

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEARS ENDED DECEMBER 31, 2017 AND 2016

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, 2017 and 2016, 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, 2017 and 2016, 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

March 27, 2018

PACIFIC ISLANDS DEVELOPMENT BANK

Statements of Condition
December 31, 2017 and 2016

<u>ASSETS</u>	<u>2017</u>	<u>2016</u>
Cash and cash equivalents	\$ 3,979,226	\$ 2,296,695
Loans receivable, net	11,242,552	11,106,544
Interest receivable, net of an allowance of \$21,003 and \$70,000 at 2017 and 2016, respectively	173,517	186,352
Property and equipment, net	<u>45,461</u>	<u>56,100</u>
	<u>\$ 15,440,756</u>	<u>\$ 13,645,691</u>
 <u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
Liabilities:		
Other liabilities	\$ 30,361	\$ 25,236
Long-term debt	<u>3,036,991</u>	<u>3,167,205</u>
Total liabilities	<u>3,067,352</u>	<u>3,192,441</u>
Commitments		
Stockholders' equity:		
Capital stock	9,302,649	8,502,649
Retained earnings	<u>3,070,755</u>	<u>1,950,601</u>
Total stockholders' equity	<u>12,373,404</u>	<u>10,453,250</u>
	<u>\$ 15,440,756</u>	<u>\$ 13,645,691</u>

See accompanying notes to financial statements.

PACIFIC ISLANDS DEVELOPMENT BANK

Statements of Income
Years Ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Loan interest income	\$ 1,038,661	\$ 914,134
Other interest and dividend income	<u>2,777</u>	<u>1,182</u>
	1,041,438	915,316
Provision for loan losses	68,000	80,000
Provision for interest receivable	<u>82,395</u>	<u>-</u>
	<u>891,043</u>	<u>835,316</u>
Operating expenses:		
Salaries and related expenses	236,113	258,941
Conference and travel	112,447	114,594
Insurance	28,901	29,618
Professional fees	19,302	22,238
Office rental	20,784	20,951
Depreciation	15,084	15,568
Board meetings	7,750	12,259
Office supplies	7,536	8,368
Communications	6,337	11,578
Business development and marketing	4,676	6,022
Automobile	1,780	3,326
Miscellaneous	<u>13,069</u>	<u>13,453</u>
Total operating expenses	<u>473,779</u>	<u>516,916</u>
Operating income	<u>417,264</u>	<u>318,400</u>
Other income (expense):		
Restricted contributions from Yap State Government	750,000	-
Other income	36,439	51,152
Interest expense	<u>(83,549)</u>	<u>(56,664)</u>
Total other income (expense), net	<u>702,890</u>	<u>(5,512)</u>
Net income	\$ <u>1,120,154</u>	\$ <u>312,888</u>

See accompanying notes to financial statements.

PACIFIC ISLANDS DEVELOPMENT BANK

Statements of Changes in Stockholders' Equity Years Ended December 31, 2017 and 2016

	Shares of		Retained Earnings			
	Common Stock	Common Stock	Appropriated	Unappropriated	Total	Total
Balance at December 31, 2015	7,510	\$ 7,510,649	\$ -	\$ 1,637,713	\$ 1,637,713	\$ 9,148,362
Issuance of common stock	992	992,000	-	-	-	992,000
Net income	-	-	-	312,888	312,888	312,888
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	<u>9,302</u>	<u>\$ 9,302,649</u>	<u>\$ 750,000</u>	<u>\$ 2,320,755</u>	<u>\$ 3,070,755</u>	<u>\$ 12,373,404</u>

See accompanying notes to financial statements.

PACIFIC ISLANDS DEVELOPMENT BANK

Statements of Cash Flows Years Ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Cash flows from operating activities:		
Net income	\$ 1,120,154	\$ 312,888
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	15,084	15,568
Provision for loan loss	68,000	80,000
Provision for interest receivable	82,395	-
Restricted contributions from Yap State Government	(750,000)	-
(Increase) decrease in interest receivable	(69,560)	69,266
Increase (decrease) in other liabilities	5,125	(660)
Net cash provided by operating activities	<u>471,198</u>	<u>477,062</u>
Cash flows from investing activities:		
Loan originations and repayments, net	(204,008)	(1,150,063)
Proceeds from sale of property and equipment	-	8,500
Additions to property and equipment	(4,445)	(6,796)
Net cash used in investing activities	<u>(208,453)</u>	<u>(1,148,359)</u>
Cash flows from financing activities:		
Proceeds from long-term debt	-	762,571
Repayment on long-term debt	(130,214)	(127,979)
Proceeds from issuance of capital stock	800,000	992,000
Restricted contributions from Yap State Government	750,000	-
Net cash provided by financing activities	<u>1,419,786</u>	<u>1,626,592</u>
Net change in cash and cash equivalents	1,682,531	955,295
Cash and cash equivalents at beginning of year	<u>2,296,695</u>	<u>1,341,400</u>
Cash and cash equivalents at end of year	<u>\$ 3,979,226</u>	<u>\$ 2,296,695</u>
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest	<u>\$ 83,549</u>	<u>\$ 56,664</u>

See accompanying notes to financial statements.

PACIFIC ISLANDS DEVELOPMENT BANK

Notes to Financial Statements
December 31, 2017 and 2016

(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, 2017 and 2016, 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, 2017 and 2016

(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, 2017 and 2016, 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 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, 2017 and 2016

(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, 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 27, 2018, 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, 2017.

(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, 2017 and 2016

(2) Loans Receivable, Continued

A summary of the balances of loans at December 31, 2017 and 2016 follows:

	<u>2017</u>	<u>2016</u>
Commercial – PIDB direct loan program	\$ 6,604,295	\$ 6,199,994
Residential loans	2,457,424	1,905,042
Commercial – USDA Intermediary Relending Program (IRP)	1,066,476	1,430,359
Consumer	1,000,070	1,341,639
Commercial – FSMDB import/export	<u>791,244</u>	<u>832,627</u>
Gross loans	11,919,509	11,709,661
Less: allowance for loan losses	<u>(676,957)</u>	<u>(603,117)</u>
Net loans	\$ <u>11,242,552</u>	\$ <u>11,106,544</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, 2017 and 2016 was \$373,000 and \$384,000, respectively.

(3) Allowance for Loan Losses

A summary of the changes in the allowance for loan losses for the years ended December 31, 2017 and 2016, follows

	<u>2017</u>	<u>2016</u>
Balance at beginning of year	\$ 603,117	\$ 539,446
Loans charged off	-	(26,266)
Recoveries of loans previously charged off	5,840	9,937
Provision for loan losses	<u>68,000</u>	<u>80,000</u>
Balance at end of year	\$ <u>676,957</u>	\$ <u>603,117</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, 2017 and 2016

(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, 2017 and 2016:

	<u>Pass</u>	<u>Special mention</u>	<u>Sub- standard</u>	<u>Doubtful</u>	<u>Total</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>
<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>

PACIFIC ISLANDS DEVELOPMENT BANK

Notes to Financial Statements
December 31, 2017 and 2016

(3) Allowance for Loan Losses, Continued

The following presents by class, an aging analysis of the Bank's loan portfolio as of December 31, 2017 and 2016:

	<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>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>
<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>

At December 31, 2017 and 2016, impaired loans of \$940,047 and \$897,485, respectively, represent loans classified as Doubtful, with total recorded allowances of \$470,023 and \$448,742, respectively.

(4) Property and Equipment

A summary of property and equipment as of December 31, 2017 and 2016, is as follows:

<u>Description</u>	<u>Estimated Useful Lives</u>	<u>2017</u>	<u>2016</u>
Computer and software	5 years	\$ 63,700	\$ 63,700
Vehicles	5 years	64,946	65,014
Leasehold improvements	3 years	31,162	31,041
Office furniture and equipment	10 years	<u>29,491</u>	<u>25,097</u>
		189,299	184,852
Less accumulated depreciation		<u>(143,838)</u>	<u>(128,752)</u>
		\$ <u>45,461</u>	\$ <u>56,100</u>

PACIFIC ISLANDS DEVELOPMENT BANK

Notes to Financial Statements
December 31, 2017 and 2016

(5) Long-Term Debt

Long-term debt as of December 31, 2017 and 2016, consists of the following:

	<u>2017</u>	<u>2016</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.	\$ 311,407	\$ 329,339
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.	545,812	570,903
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.	598,035	624,142
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.	256,619	271,386
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.	325,118	371,435
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>1,000,000</u>	<u>1,000,000</u>
Total	\$ <u>3,036,991</u>	\$ <u>3,167,205</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, 2017, future maturities of long-term debt are as follows:

Year ending December 31,

2018	\$ 193,328
2019	213,279
2020	197,146
2021	226,188
2022	233,006
Thereafter	<u>1,974,044</u>
	\$ <u>3,036,991</u>

PACIFIC ISLANDS DEVELOPMENT BANK

Notes to Financial Statements
December 31, 2017 and 2016

(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 are included as part of appropriated retained earnings.

As of December 31, 2017, \$750,000 has been received and two loans totaling \$337,000 have been funded under the program, of which \$320,069 represent outstanding balances included as a component of loans receivable in the accompanying statement of condition.

(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 commitment under the lease is \$10,392 for the year ending December 31, 2018.

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, 2017 and 2016, the Bank contributed \$10,763 and \$11,661, respectively, to the Plan.