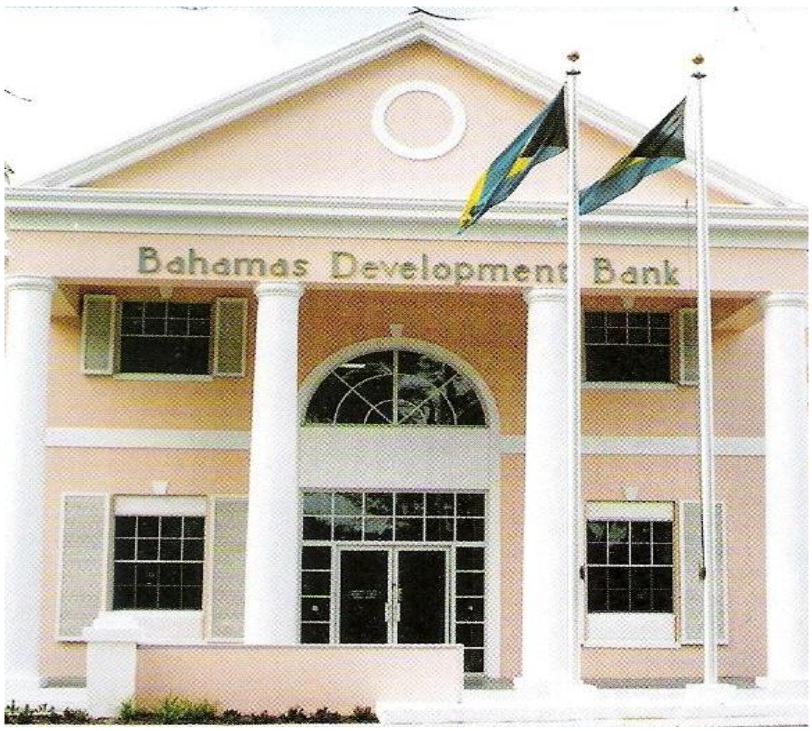
BAHAMAS DEVELOPMENT BANK
ANNUAL REPORT 2010



FORGING AHEAD WITH RESILIENCE

TRIBUTE

The financial management and reporting for the Bahamas Development Bank is performed by its Accounting Department, led by the Financial Controller. This year we lost our Financial Controller, a dear colleague and friend Ms. Catherine Patton. Catherine's untimely death was a tremendous loss to this institution, the Bahamas and the world at large. We pay tribute to the selfless, giving life of Ms. Patton, as the Department, led by a newly appointed Controller, seeks to honor her fine legacy of excellence.

The Macro and Micro Environment

International Economic Context

The global economy for the greater part of 2010 was in turmoil, stemming from the initial crisis, internationally, in the sub-prime mortgage market. The economies of the major international trading partners of the Bahamas, USA and United Kingdom, experienced much contraction, notwithstanding attempts at stimulating economic activities through a variety of bail-out packages. Employment statistics and consumer confidence deteriorated sharply.

However, according to the International Monetary Fund (IMF), there was some rebound in the global economy towards the latter part of the year and financial conditions were improving markedly. Given the lag effect, conditions remained generally difficult for many economies with the exception of China, India and Brazil, which continued to experience growth, albeit at a reduced rate. Regional economies, which have become increasingly dependent on tourism-related services, were seriously impacted, with many of them experiencing negative economic growth.

Domestic Economic Development

Indications are that the domestic economy maintained a stable trajectory during 2010, supported by a modest improvement in tourism output, as the recovery took hold in the main source markets. However, construction activity remained mild, owing to subdued foreign tourism-related investment and domestic private sector projects. In this context, consumer demand conditions were relatively weak, being further hindered by the continuing high unemployment levels. On the price index side, inflation was benign, despite the modest firming in international oil prices. The contraction in economic activity was influenced by declines in the main productive sectors of tourism, construction and agriculture. These factors impacted the financial results of the Bank.

The attendant issues of corporate governance and regulation has caused the Bank to consider as its theme, **“Forging Ahead with Resilience”** – representing the strategy required to propel and sustain the institution. It is important that those concerned adopt this view given the contraction in economic activity arising from the decline in the major production sectors of the economy, and the resulting increase in the level of unemployment. The contraction in the economy reinforced the need for the survival of the BDB, an institution that has provided sterling support to the economy for more than twenty eight (28) years.

Management's Overview & Discussion

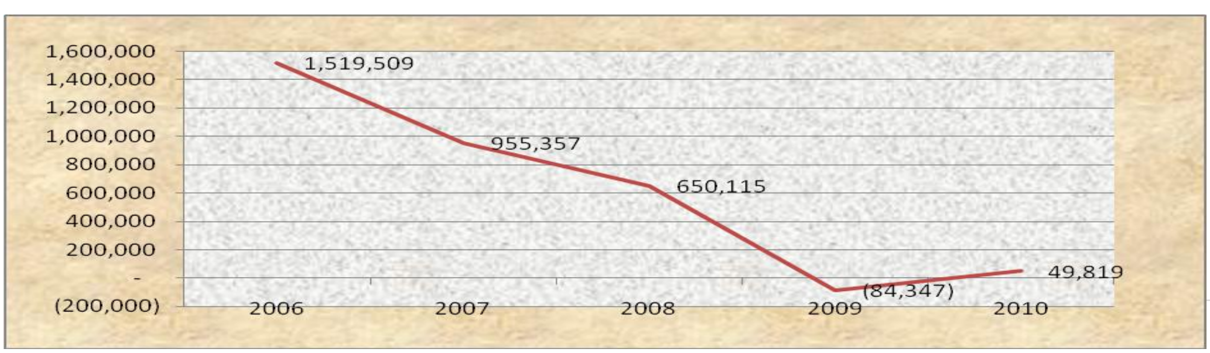
Financial

The overall financial performance of the Bahamas Development Bank has been one of improvement. Although the Bank experienced a loss for the year 2010, the loss is significantly less than the previous year, reflecting the Bank's strides in various aspects of its financial performance.

Net Income

The loss for the year was approximately $1.0 million, compared to $2.7 million in 2009, an improvement of $1.7 million and $5.3 million in 2008. There were several major contributing factors to this achievement; chiefly the submission of government guarantee claims that amounted to $.9 million recovery of loan losses. Other significant contributing factors were a reduction in loan interest and an increase in other income as well as management's commitment to reducing expenses evidenced by the continued decreases in salaries and general and administrative expenses.

Net Interest Income

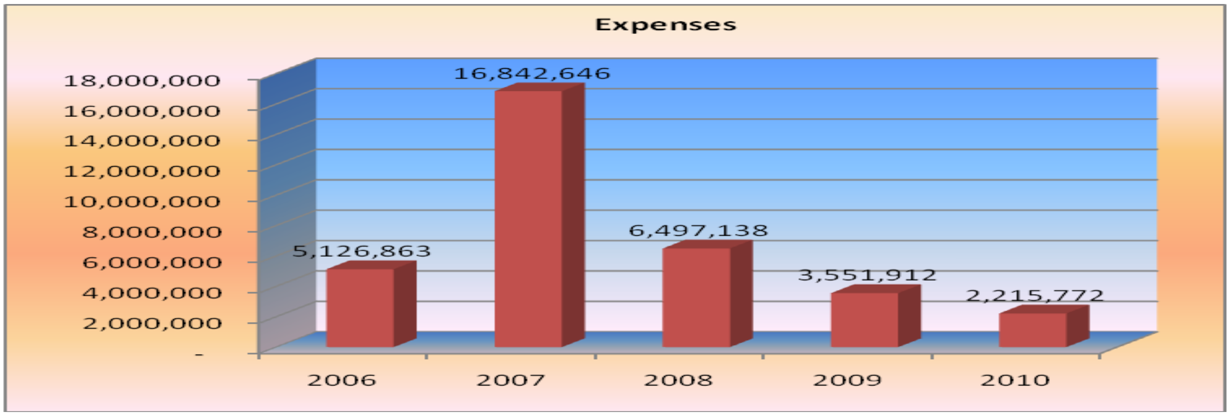


The Net Interest Income (NII) was $49,819 this year. Although Net Interest Income has been decreasing over the past several years, we have seen a slight increase in 2010 despite the weakening of the loan portfolio. The BDB was able to keep a steady level of loan interest income at $2.5 million in 2010 and 2009, however this level represents a 22% decline from 2008. The change in NII is due mainly to the reduction in interest expense from the servicing of long term debt - which has had a fairly constant interest level.

Other Income

Other Income increased by $123,383 to $213,167 in 2010. This was due mainly to a foreign exchange gain on European debt and an increase in loan recovery.

Operational and Administrative Expenses



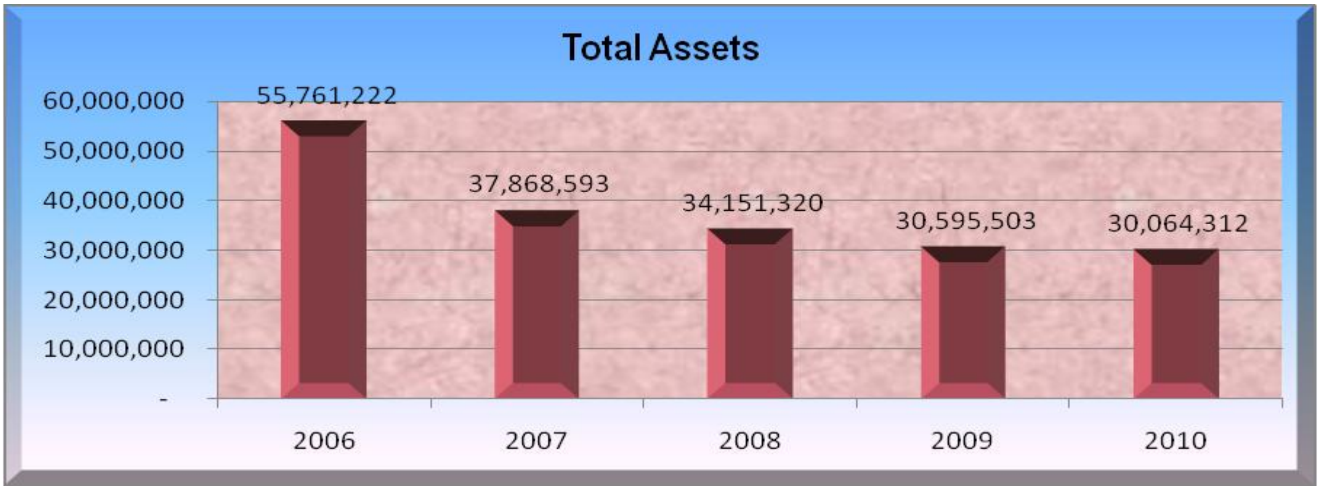
At $2.2 million, total expenses decreased by $1.3 million or approximately 38% - a trend that has continued from 2008. The decrease in expenses can be attributed to three major expense classes:

- **Recovery of Loan Losses** - the Bank for the first time in its recent history, has been able to enjoy a recovery from loan losses. The recovery of $.7 million net is explained in detail in the Bank Operations section of this report.

- **Salaries and staff expenses** have declined by $209,789 to $2,437,559 due to Management's attrition plan. With a definitive attrition plan geared towards the reduction in staff costs, Management reduced the staff compliment from 42 employees to 38. Details of the plan can be found in the Human Resources section of this report.

- **General and administrative expenses** have declined by $128,148 to $432,654 due to a reduction in monthly expenses achieved through strict adherence to budgeted amounts as well as prudent spending. Addtionally, during the period 2009/2010, Management began a methodical process of reviewing its administrative contracts among its various vendors and service providers. Areas such as security, office supplies, building maintenance, vehicle operating expense, consulting fees, legal fees, staff travel, and telephone service (land and wireless) were reviewed with action being immediately taken to reduce costs in these areas. Plans were developed to address exorbitant expenses, measures were taken internally to curtail spending, contracts were re-negotiated and service providers whose focus was the provision of proper customer service were selected. In as much as this approach by Management resulted in a decrease in general administrative expenses to the tune of $128,148.00, this process will continue in 2011.

Total Assets



Total Assets have remained relatively steady at $30,064,312 compared to $30,595,503 in 2009 although there have been significant increases and decreases in particular asset classes:

- Fixed Assets have increased by almost 55% from $350,629 to $543,302 with the purchase of a new Loan Information System (details of which can be found in the Information Technology section of this report).
- Cash at Bank has more than quadrupled from $543,302 to $2,349,035 due mainly to the Bahamas Government's continued support of the BDB through the paying of its long term debt.
- Accrued interest receivable has also increased dramatically due mostly to the recording of daily accruals for interest income from fixed deposits.
- The decrease in loans receivable has balanced the above-mentioned increases so that the overall change in total assets is negligible.

Total Liabilities have increased slightly from $50,443,846 to $50,904,304, although there have been significant changes in particular liability classes:

- Customer deposits have decreased from $1,041,529 to $436,724 due to sharp drops in security deposits and a change in the use of the client funds account which is now titled “Other customer deposits/advances – net”.

- Security deposits have been applied against non-performing loans to liquidate the accounts.
- "Other customer deposits/ advances – net" includes carried-forward balances and deposits made by customers for use in expenditures made on their behalf by the BDB as well as charges for such expenditure necessitated by collection efforts (such as storage, legal fees, advertisements etc.) where the funds were not in the client account. The net result of such transactions this year was ($172,137) for a $344,274 reduction in overall customer deposits.

- Accrued interest payable has also decreased due to timely payments of interest due to our creditors, by the Bahamas Government. Liabilities also include a new classification of "Due to the Bahamas Government" which includes all payments made on behalf of the BDB less any claims (government guarantee, interest subsidy) approved for payment to the BDB.

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Without any additional capital injection from the Bahamas Government, shareholder's equity remains unchanged from the previous year.

Bank Operations

2010 was a very challenging year. High unemployment, pervasive uncertainty and apprehension about the economy, reduced aggregated demand, and industry-wide tightening of credit contributed to increased hardship and payment difficulties for our customers. Many BDB clients were unable to service their indebtedness to us due to lower sales volumes, increased costs, or closure of their operations.

Despite the conditions in the economy, we made progress on a number of non-performing accounts in 2010. At December 31st, approximately $3.0 million in accounts were eligible for restructuring under the Bank's policy. However management decided not to process those restructures at the time, given the economic conditions and level of uncertainty. Expectations are that as the economy returns to positive growth in 2011 the risks associated with those accounts will decline sufficiently to permit their restructuring.

Our efforts to liquidate non-performing assets met with moderate success. In 2010 we sold assets valued at $936,960.04. Unfortunately, obstacles from Government institutions were experienced when seeking to liquidate leasehold assets. In 2010, we were unable to conclude sales of mortgaged leaseholds valuing $800,000.00 because we were unable to obtain leasehold extensions and transfers in a timely manner (within 6-12 months).

At present, assets listed for sale exceed $8.0 million. Management is taking steps to maximize exposure of these properties for sale and to create policies that will remove traditional barriers to having them sold. These initiatives include employing the web more effectively, publishing a newspaper supplement advertising properties for sale, providing financing to qualified bidders under specific circumstances, and facilitating possible payout agreements.

Lending was marginal – primarily due to extremely limited resources and the reluctance of many to venture into business. During 2010, the BDB approved twenty-five loans valuing $1.2 million. Eighteen of those loans totaling $.69 million were disbursed.

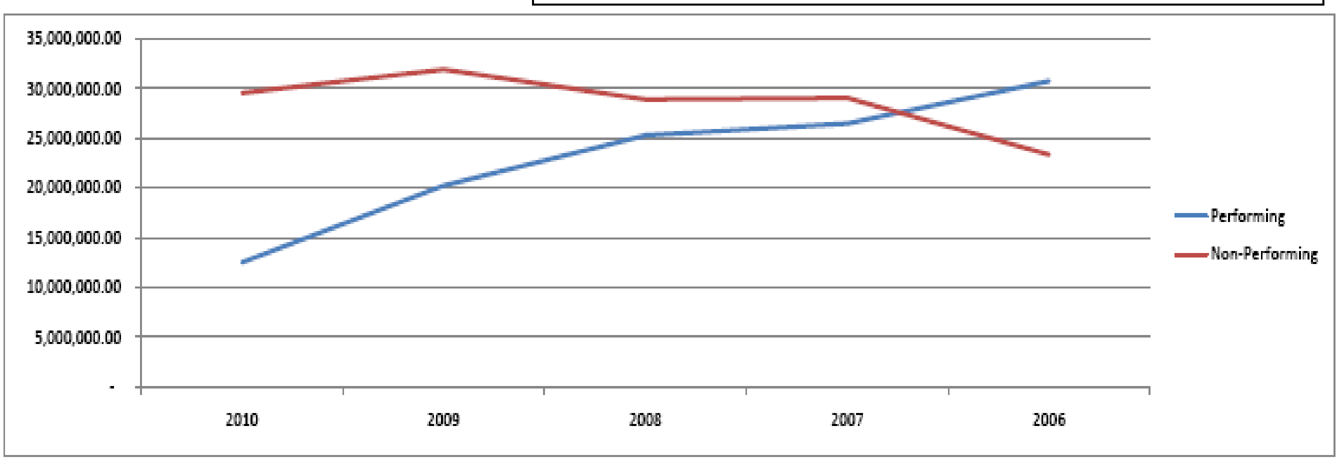
Table 1 - Summary of Portfolio Activity

Portfolio Opening Balance		52,148,099
Add New Loans		647,846
		52,795,945
Less: Loan Write-Offs Against Provision	7,651,583	
Loan Run-off / Payouts/Liquidations	3,094,813	
Less Portfolio Exits		10,746,396
Portfolio Closing Balance		42,049,549

Table 1 summarizes the BDB's portfolio activity for the period under review. Overall, the loan portfolio plummeted by 19%. The decline was due primarily to loan write-offs, which accounted for 71% of Portfolio exits during the year (please refer to Table 1). The remaining 29% consisted of payouts, liquidations, and loan run-offs. Efforts to collect a significant portion of the loans written-off will continue.

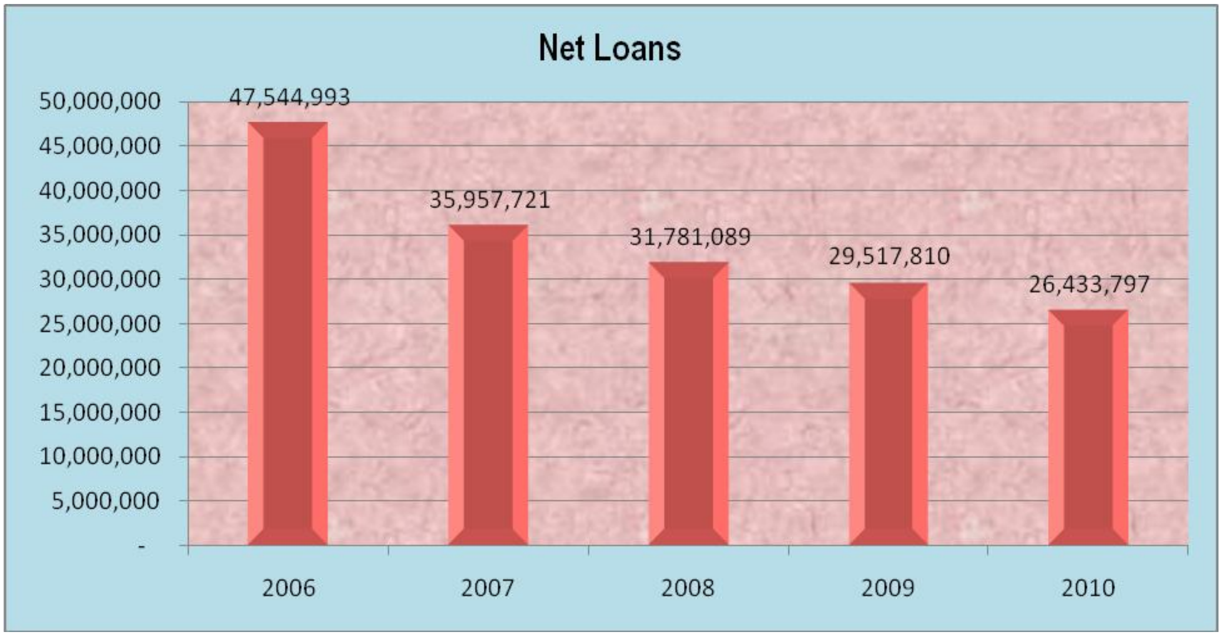
Going forward, emphasis will be placed on increasing performing assets. Initially, this will be accomplished through an aggressive but prudent program of loan restructuring and loan refinancing. Simultaneously, Management will implement programs to increase and expedite loan approvals. These programs will target mainly two productive sectors: the manufacturing industry and the agriculture industry.

Performing / Non-Performing Accounts



The level of non-performing loans (although slightly reduced from last year) outpaced performing loans in the portfolio; resulting in a nine (9) percentage point increase in the non-performing rate. Contributing to this was a slippage of approximately $5.3 million in value, particularly among accounts in the commercial fishing and hotel sectors in the Family Islands.

At $26.4 million net loans were down by 3.1 million or 12% from the previous year.



The Allowance for Doubtful Accounts declined from $24.5 million to $16.9 primarily because the Bank's decision to write-off the most risky accounts in its portfolio. Consequently, the provision for doubtful debts dropped from 82% of the loan portfolio to 64% of the total loan portfolio.

Allowance for Doubtful Accounts

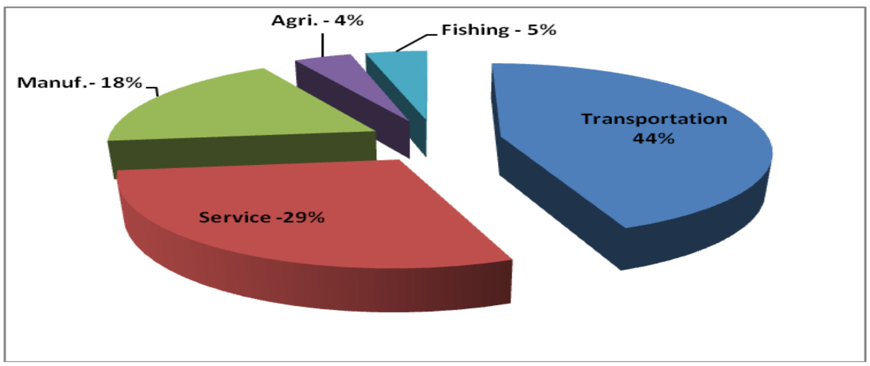
In 2010 the Government approved settlement of several loans guaranteed under its Small Business Loan Guarantee Program. Twenty-four claims totaling $867,552.39 were processed in 2010. It is anticipated that another $1.0 million in claims will be processed in 2011.

DEPARTMENTAL REVIEWS

CREDIT DEPARTMENT

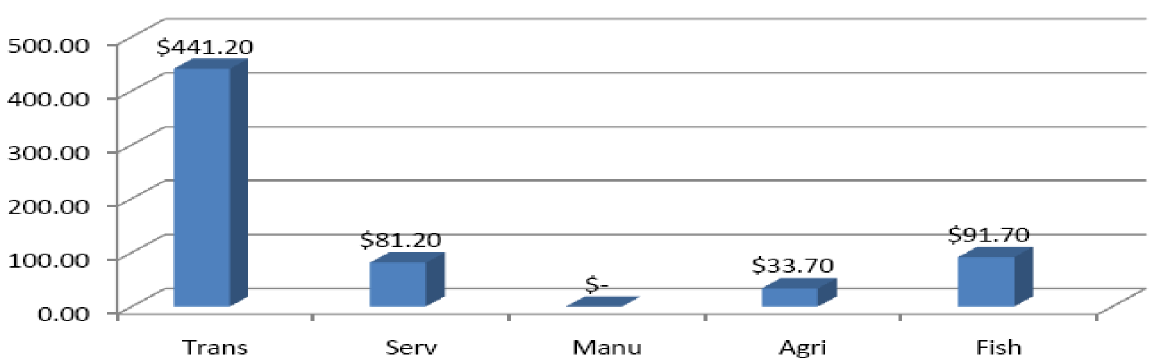
In January 2010, the Bank's cash balance stood at $532,731.00. Due to limited funds, the department was unable to engage in significant lending. However, during the year, 25 loans were approved totaling $1.2 million. This represents a slight improvement over the previous fiscal year, during which eighteen (18) loans, with an aggregate value of $688,000 were approved.

LOAN APPROVALS BY SECTOR – 2010



Of the amount approved, actual amounts disbursed in 2010 totaled $647,846.82. This compares favorably with $553,343.90 disbursed in 2009.

LOAN DISBURSEMENTS BY SECTOR – 2010 (in thousands)



In 2011, the Bank proposes to focus its credit efforts on productive sector loans with moderate risks and employment generation potential (i.e. projects that create two or more sustainable jobs). A stated goal of this effort is to book a minimum of $2.5 million in incremental loans during the year. As a means of achieving this goal, the Bank will host several closed, non-publicized workshops with target groups and work with potential borrowers to establish new businesses. Additionally, we will seek to assist our existing B to A-1 customers with the recapitalization of their operations as needed.

HUMAN RESOURCES

With the new framework in place from October 2009, the Human Resources Department refocused its attention in order to maximize performance, reduce waste and improve internal and external effectiveness. With this forming the foundation of the Human Resources strategic plan for 2010, the watch words became timeliness, proper management, cost effectiveness and adding value to the organization as a whole.

Through a definitive attrition plan geared towards the reduction in staff cost, the staff compliment was reduced from 42 employees to 38, thereby enabling the Bank to realize a saving in personnel emoluments of **$209,789.00**. The attrition plan also reduced other staff benefit costs company wide. The staff was then required to become efficient and effective in the execution of their duties. Reliance and attention was given to proper time management, and linking expected performance to that of the redesigned job descriptions. Further, the reward system was then linked to a carefully devised merit increase system which was linked to a specifically developed "management by objectives" system. This method proved to be reliable, given the fact that performance output over the year increased tremendously.

Additionally, the Board through the Human Resources Department shifted some of their focus to reduction of the overall cost of the medical insurance and negotiating a change in the management of the pension plan. The result was a change in the medical health care provider and a reduction in medical cost to the Bank in the amount of **$52,445.00** for the period. It should be noted that the rising cost of health care worldwide will result in a slight increase for the period 2011/2012.

The cost savings movement did not stop there. The Bank moved to convert the Defined Benefit pension plan to a Defined Contribution plan. This conversion was undertaken with a view of reducing the Bank's pension cost, to give employees the option to increase their retirement benefits and to give employees direct control over the investment of their retirement funds. Several providers were considered and a decision was made to select the company, who could best work with the Bank to manage the retirement plan. It is anticipated that this decision would result in a difference in this expense to the Bank of approximately **$93,000.00 per annum**.

INFORMATION TECHNOLOGY

February 2010 the Development Bank replaced its antiquated loan management system at a cost of $367,072 with a program designed by Gresham Computing of Toronto Canada. The transition to the new system was substantially completed by May 1, 2010 as scheduled. It was also completed within budget. End-users were trained via a train-the-trainer program – which was relatively effective among the loan staff.

Management was of the view that a new Loan Management System was imperative for the delivery of vital information needed to meet the demands of the anticipated growth of our Loan Portfolio. A new Loan Management System was necessary in helping to deliver this information - replacing the legacy Development Financial Services (DFS) system that the BDB was using at that time. After due diligence was conducted, the Bank selected the Clareti Banking System

The system now enables officers to monitor accounts to control delinquency and non performing ratios. In addition to the above-mentioned, the Bank also acquired Clareti Lending System which is used by our Credit Department to assist in the loan application process of new clients. It is expected that the new Loan Management System will improve the effectiveness and efficiency of the loan cycle.

The product is highly modular and as such, it is expected that the Bank's immediate needs will be met while allowing for the flexibility to add additional modules when and as the need arises or as the technology becomes available. Clareti Banking allows financial reporting on a “branch by branch” basis. It provides an extensive system of permissions that allows the administrator to define access levels of each user. Initially financial reporting was a challenge. With the additional technical training received by IT personnel, this obstacle should be overcome in short order. The operational costs of the new system are approximately $13,200 per month. Pre Clareti costs were approximately $5,200 per month.

LOOKING AHEAD

In 2011 the Bank will strategically continue its efforts in significantly reducing risk exposure, while improving portfolio performance. As noted earlier, primary focus will be on supporting the Manufacturing and Agricultural sectors through methodical marketing efforts and operational assistance among the various agencies. Extensive improvements will be made to our service delivery while further operational reform will be implemented to enhance our clients’ experiences.

In forging ahead with resilience, it is the hope of Management and the Board that a decision regarding the Bank’s future be made in light of its continued relevance, notwithstanding an indisputable need for a modern, proven and sustainable, lending model. The staff of the Bank is committed to this institution’s necessary metamorphosis, and ready to provide outstanding customer service.

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