

The
Bahamas
Development
Bank

2009

This Annual Report and accompanying Audited Financial Statements are presented in accordance with Section 22(1) of The Bahamas Development Bank Act.

Annual Report

Introduction

The Fiscal 2009 Financial Strategy: A Matter of Survival

The Board began and ended 2009 with laser-like focus on a single mission to assess the Bank's financial viability and take aggressive steps to ensure deliberate action to set a course for the future. The initial introspection concluded with a document entitled "A Critical Assessment of the Role, Impact and Necessity of The Bahamas Development Bank" dated February 16, 2009.

As a result of that initial review—and in consideration of the financial position at the beginning of the year—the core element of the Bank's financial strategy for 2009 was fairly evident—manage the limited financial resources in such a way as to sustain business operations, while the Board and Government explored all options *and justifications* for the organization's continuation as a going concern.

Presentation of Financial Options

Following the initial assessment, the next step was a comprehensive evaluation of financial options for the Bank. This was achieved through the development of a robust and fairly sophisticated financial model, the primary objective of which was to test the impact that a broad range of lending and operational strategies would have on the Bank's financial position over the short and long-term.

This was an extremely beneficial exercise! The output of the model presented very clear realities that had to be considered in the deliberations of the Board and Government.

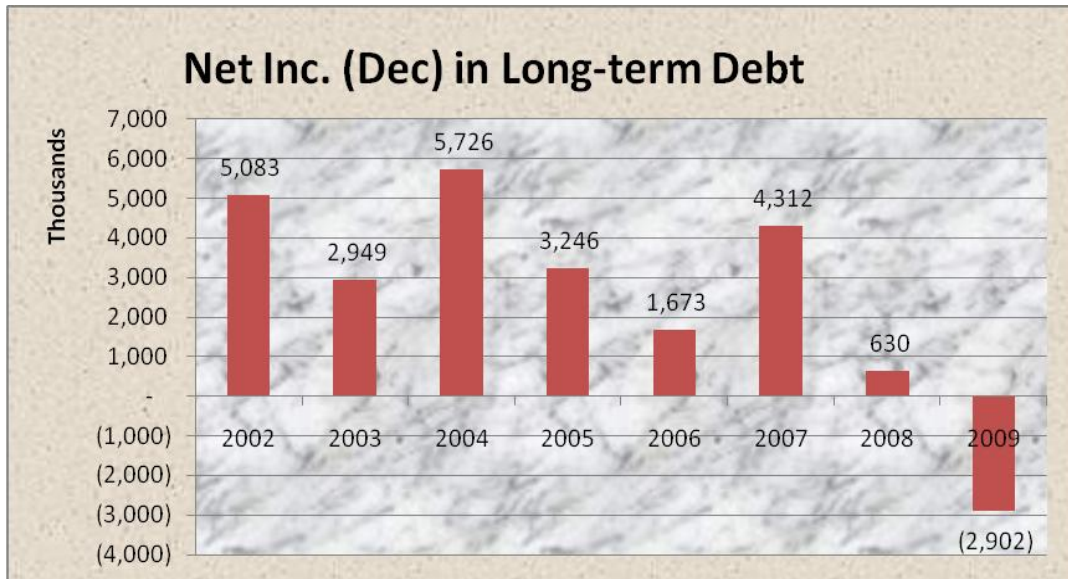
In a report entitled "The Bahamas Development Bank, Financial Options for the Continuation of Banking Operations", dated July 13, 2009, the results of this assessment were communicated to the Ministry of Finance (MOF). As the details of the report have been presented to the MOF and are before Cabinet for evaluation, the substance of that report will not be repeated here. The Board is pleased that, as expected, the substance of the report is proving useful in informing Government's decision-making process.

Managing the Impact of Diminished Funding and Sources Thereof

As previously reported, in 2005, Parliament unanimously approved a guarantee for the Bank to issue a further series of bonds in the amount of twenty-five million dollars (\$25,000,000). The intent was to ensure the availability of resources for onward lending “over the next few years.” This action followed upon a similar exercise in 2000 when the BDB signed an agreement with the Caribbean Development Bank for a new line of credit of US\$ 10 million for utilization over the years 2000 to 2003.

Early in 2009 the Bank issued the final series of approved bonds. In so doing, this represented the last clear source of immediate funding for onward lending. As discussed in previous submissions, the Board envisioned this reality from the commencement of its term, and had been making necessary adjustments in anticipation of the final series.

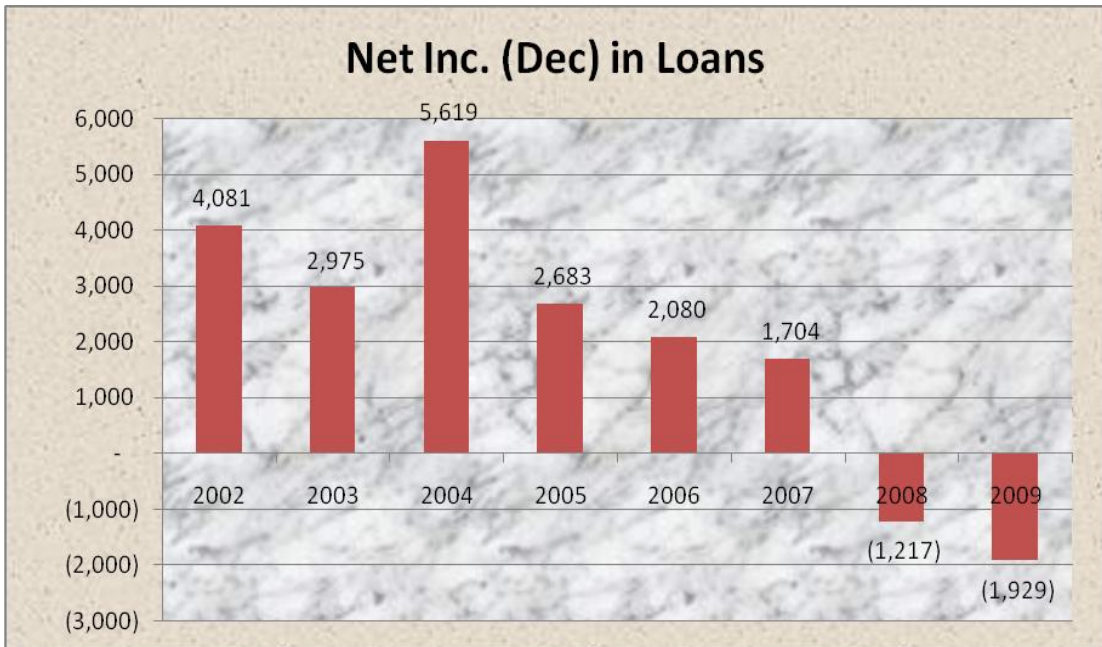
The following table reflects the net movements in long-term debt between 2002 and 2009. Beginning in 2008, sinking fund contributions and loan repayments began to outstrip cash inflows from issuance of new debt.



Lending

By necessity, the impending cash flow “day of reckoning” made it imperative that lending be diminished. This commenced almost immediately with the commencement of the new board and was intensified for the major part of 2009. **Lending never stopped.** Nevertheless, the confluence of the overall economic slowdown and the limited funds available for onward lending necessitated that the BDB exercise greater selectivity in the nature and extent of projects funded. In the latter part of the year when the funding arrangements were firmed-up, the Bank recommended lending—with continued high selectivity—for larger amounts and for more substantive projects.

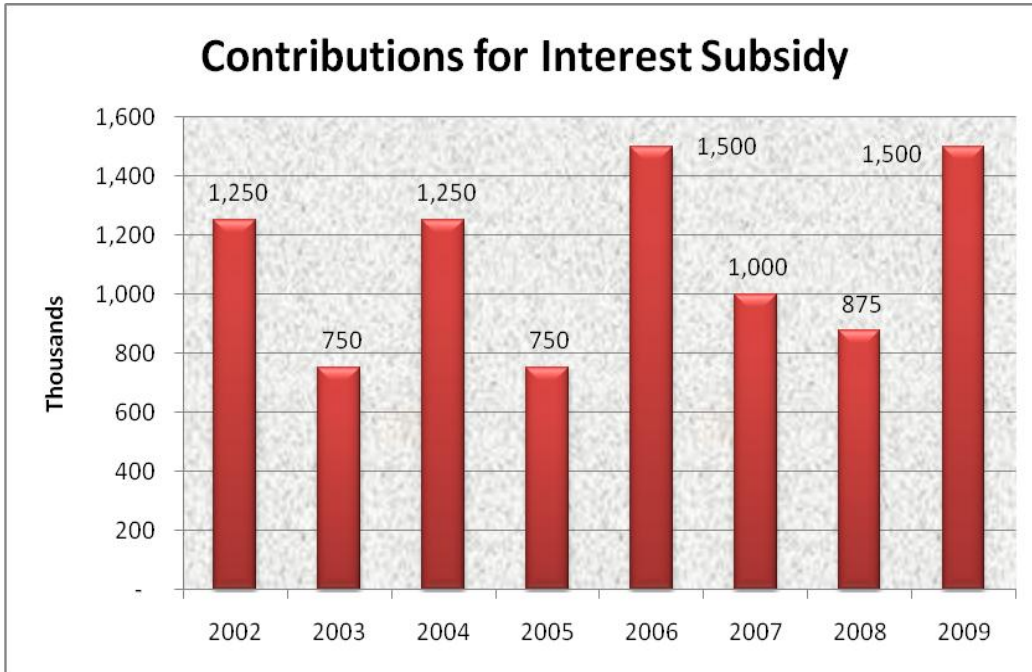
The table below reflects the lending performance over the last eight years. The amounts presented are net of provisions for bad debt, and reflect the fact that lending was intense between 2002 and 2004, slowed between 2005 and 2006, and began to falloff in 2007, the recommencement of the “lean years.”



It must be noted that the foregoing two graphs reflect a combination of proceeds of bond issuances, use of those fund for onward lending and the use of available cash resources for general operations.

Impact of the Interest Rate Subsidy

Direct funding from The Government of The Bahamas in the form of the interest subsidy is reflected in the following table.



Short-term cash flow challenges

As discussed in the accompanying financial statements for the year 2009, the last series of bonds was issued in early 2009. As evident from the foregoing discussion, the full utilization of the \$25 million facility authorized by Parliament in 2005 coincided with the *current* Government's broader assessment of the most effective methods of providing financial support to small and medium sized enterprises and, more directly, the role of the Bahamas Development Bank.

As a result of that ongoing assessment, no new credit facilities were in place at the time the 2005 arrangement expired. That factor, coupled with the high level of operating expenses and the increase in delinquencies precipitated by the slowdown in economic activities, caused the Bank to experience a short-term liquidity crunch. Consequently, interest payments to selected domestic creditors were delayed by a few weeks in the last quarter of 2009. This shortfall was later rectified through a series of cash injections by the Government.

Auditor’s Report—the “Emphasis of Matter” Paragraph

The financial statements are prepared on a going concern basis, but include an emphasis of matter paragraph. The emphasis of this issue by the external auditors underscores the assertion that the BDB’s ability to continue as a going concern is contingent on the Government’s continued commitment to making equity contributions to fund the Bank. The last emphasis paragraph appeared in the audit opinion for the year ended December 31, 2007.

Legislation reform

During the year, the Board forwarded to the Ministry of Finance a document entitled “Proposed Amendments to The Bahamas Development Bank Act” dated March 23, 2009. Among the considerable list of heavy lifts this year, this was a particularly significant accomplishment, as it entailed a very comprehensive review of the existing legislation. The Board is especially grateful for the tremendous work of Director Janet (Lisa) Bostwick who chaired the committee. The Board would also like to highlight the invaluable contributions of former Managing Directors Messrs. Calvin Knowles, George Rodgers and Paul D. Major.

It is the Board’s view that the final report, as well as the equally comprehensive transcript of discussion notes, should be placed in the public domain so as to inform the coming discussion about small business development. (N.B. The documented discussion notes were not included in the final report).

Human Resources Management and Restructuring for the Long-term

During the year, the Board undertook a review of the Bank’s staffing, including a renewed assessment of senior leadership. The exercise concluded with a decision to reenergize the executive team given the new financial and operational realities. Those structural changes were communicated to MOF under separate cover and will not be duplicated here. The highlights included:

- Options for the position of Managing Director
- A new deputy Managing Director was proposed and agreed with a view to energizing the Collections team and its strategies for collections

- A new Manager of Human Resources was engaged given the anticipated challenges required to change the organizational culture
- The Executive Management Committee was streamlined to include only the top executives. This helped ensure greater executive ownership of Bank decisions and greater accountability for execution of policies

Operational Issues—Board Mandates

The necessary work required to transform BDB is not yet completed...by a long shot. However, in view of the Government’s ongoing deliberations about the Bank’s future, the Board took great pains to restrain itself from making other necessary/desired operational decisions that had long-term implications. The Board’s working position was that it would refrain from preempting any likely decision made by Government, minimize legacy issues, and give the Government the greatest degree of flexibility in determining its policy for the Bank’s future. Within this framework, several mandates should be highlighted:

Customer relations

As disclosed and discussed publicly, the Board’s directive to management was as follows:

- Continue to accept and process applications
- Given the cash constraints, focus should only be on projects with the highest probability of success (and by extension, highest probability of loan repayment)
- Officers of the Bank should be honest with the clients. While it was not necessary to discuss the details of the Bank’s expected short-term limitations on its capacity to lend, potential clients should be advised fairly *early* in the process if their projects had any meaningful possibility of being funded
- Once an understanding was reached as to Government’s position with respect to ongoing funding, a return to robust levels of lending would still be highly contingent on the state of the local economy

Collections

In view of the limited funding from outside sources, there was no question that the Bank's ability to provide onward lending would be heavily contingent on overall collection efforts. With its own survival at stake, there was no question that the level of foreclosures would have to be increased and the nature of client interactions intensified. The mandate to the management team was direct; collect the Bank's money from the people in a position to pay. But notwithstanding that directive, remain mindful of the following realities:

- The decline of business activity in the local and global economies was likely to hit BDB clients especially hard (this reality was clearly evident by the trend of net interest income discussed below)
- Grand Bahama clients were expected to be hurt—or hurting—disproportionately hard, and special considerations would have to be given to them
- The number of complaints and appeals to the Board is expected to increase and the Board would have to be the final arbiter in balancing cash collections with providing some latitude/leniency to clients

Other Operational (Human Resources) Highlights

With a total staff of 44 at the beginning of 2009, the prevailing view was that the organization could operate more effectively with staff members who were driven by goals and clear expectations.

During the last quarter of 2009, the Human Resources department undertook a number of aggressive exercises aimed at total organizational realignment with a specific focus on achieving:

1. Greater accountability to both internal and external clients.
2. A reduction in spending through more prudent cost control.
3. Enhanced level of customer service.
4. Expedited responses and reduced turnaround times for internal and external clients by flattening the hierarchal structure of the organization.
5. Updated internal policies and standard operation procedures designed to enhance knowledge and improve timeliness of numerous operational activities for Bank clients.
6. Improved individual and team performance, based on establishing a remuneration program that, when executed, will reward high

performers. It is envisaged that this will result in the need for staff members to produce and render higher levels of customer service and greater commitment to clients.

7. Educated staff members on subject matters that will enhance specific technical skills that are necessary in evaluating the viability of the businesses our clients venture into.

Through an analytical review of the staff compliment, capabilities, past successes and failures, the above became the framework for HR management.

Strategic Policies and Procedural Changes

During the last fiscal quarter of 2009, the Bank revised a number of its policies and procedures in an effort to meet the objectives outlined above. Additionally, the Bank realigned current employees, and established internal departments geared towards providing support to clients throughout their various developmental cycles, thus improving their success rate.

1. The establishment of a Loan Administration Department

The high failure rate of funded projects revealed the need to establish a department whose major function would be to work closely with customers to assist them in improving the prospect of success for their businesses—on the front end of the enterprise. The primary purposes of this department are to:

- a. Conduct site visits to inspect project implementation and ensure customers' compliance with the terms and conditions of the loan agreement, in addition to being a support mechanism for new entrepreneurs.
- b. Conduct assets inspections to ensure that collateral assigned to the Bank are operable and properly documented.
- c. Address delinquency signals prior to them becoming a reality for customers.
- d. Review customer files periodically to ensure timely maintenance of all necessary insurance contracts.

The department has assumed responsibility for all fully functioning projects throughout the Bahamas. While the work undertaken by this new department is in its infancy stage, its future and the extent to which its mandate changes is contingent upon the Government's overall position on the Bank's long-term agenda.

2. The realignment of departments within the Bank for greater accountability to our clients

In addition to the establishment of the Loan Administration Department, another major policy change involved the realignment of the departments and the current staff, geared towards creating greater efficiency for quicker response times to customers. The frustration of waiting for long periods of time to get responses to queries and status updates on loan applications has been reduced considerably. This has been achieved through a flattened hierarchical structure, merged departments, streamlined procedures and right-fitting of employees. Customer communication has also been improved. Specific officers have been assigned to log and manage customer call details so as to avoid the frustration of repetition of comments, queries and concerns by the customer. Additionally, the Bank has linked compensation to customer satisfaction and performance to ensure that employees have a vested interest in the provision of satisfactory customer service and improve accountability simultaneously.

3. Improvement of operational policies (for greater customer service delivery and standardization)

All of the Bank's policies are under active review with a view to improving customer service and enhancing processes within the operational functions of the Bank. The policies under review will affect delinquency control, credit and employee relations. Within the coming months, this information will be concluded, and the public, through communications or calls from the Bank, will be apprised of these new and improved developments. The Bank's revised policies simplify processes and clearly define ways to provide direct benefits to its customers.

In addition to the foregoing, the following actions have been taken:

1. The Bank has created and implemented a system that measures and reports employee productivity (on a weekly basis) and provides immediate feedback to staff on their performance, particularly in its Collections, Credit and Loan Administration Departments.
2. The Bank has trained its Managers to use productivity reports as a management tool for planning and evaluating performance.
3. The Bank has redesigned its website and has upgraded its content and features. The upgraded site contains, inter alia, relevant lending policies and a loan estimator, and also displays a section that permits the viewing of all repossessed assets for sale.
4. The Bank has created an e-mailing database of all real estate agents that are members of the Bahamas Realtors Association, and have provided a general listing of our repossessed properties to all registered agents.
5. The Bank has commenced a comprehensive loan review process to determine which accounts can be reasonably rehabilitated and those that cannot.
6. The Bank has completed a comprehensive audit of all personnel files to ensure full compliance with legal requirements, and has taken steps to correct all breaches.
7. Job mandates and expectations have been revamped, and a consistent in-house training program for all staff has been implemented.

The Future for The BDB

Strengthening the Bank's Systems

At the time of its initial appointment in 2007 the Board was greeted with a series of unsettled issues. One of these was the hugely vexing problem of the Bank's obsolete and ineffective core banking system. Immediate steps were taken to evaluate options to find an appropriate replacement.

After repeated delays in making a final decision—due to the unanswered question of going concern—the Board authorized management to proceed with the acquisition and implementation of the new core banking software. The implementation commenced in late 2009 and will conclude on time and within budget in 2010.

The new software and related hardware improvements will add value to the Bank in many ways, the most important being the enhanced ability to manage the existing portfolio—under any scenario selected for the future.

Proactively Determining the Role for the BDB

Crafting legislation for the development of small businesses

The Government of the Bahamas has announced its intentions to establish a new regime for funding small and medium sized enterprises. The Board acknowledges the intention of this strategy and understands the broad goals being pursued. Legislation creating a new super-funding agency will be established in pursuit of the new policy objective.

The Board has decided to adopt a proactive posture with respect to the proposed new regime. Notwithstanding the financial challenges encountered throughout its existence, the Bank has accumulated a tremendous reservoir of knowledge and experience in assisting small businesses. In that regard, the Bank will undertake a series of initiatives designed to leverage the BDB's small business network and extensive experience in helping clients address the challenges faced in achieving success in their small businesses.

The Bank will undertake a series of round-table discussions aimed at ensuring meaningful dialogue that concludes with the presentation of well-considered advice as to how the new funding regime might achieve maximum success. This guidance is expected to include perspectives from existing and prospective small business owners, with a view towards capitalizing on their insights and collective experiences (both positive and negative).

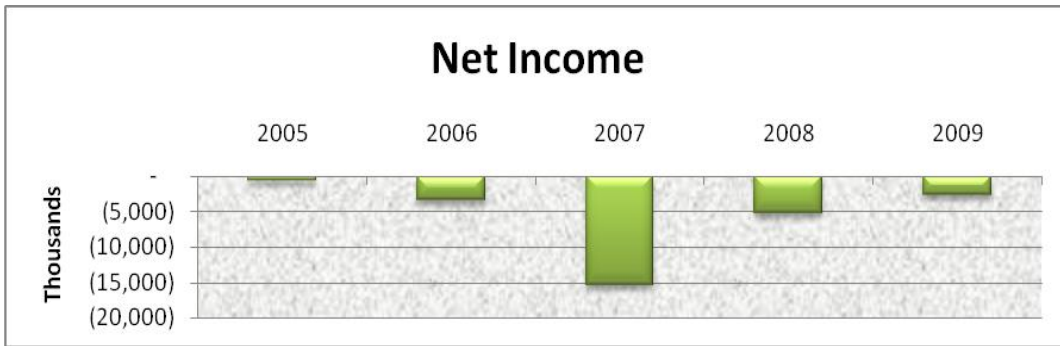
The future role for BDB

Within the context of the new legislative regime, the Board understands that no specific decision has been made about the role for the BDB in the proposed new structure. It is clear that given its role as the primary vehicle for providing developmental funding since its inception, the BDB will be impacted. The uncertainty and sensitivity as to HOW BDB will be impacted is clearly understood. The Board understands that, appropriately, all options are on the table.

An overview of the financial statements follows.

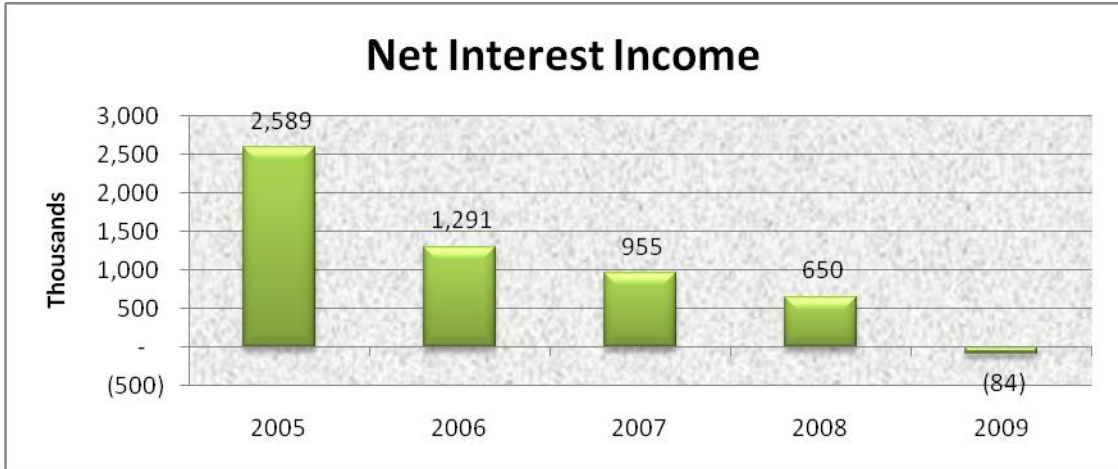
Summary of Financial Performance

The loss for the year was \$2.7 million, compared to \$5.3 million in the previous year, an improvement of \$2.6 million. This result was driven primarily by a significant reduction in loan interest and other income, offset by significant decreases in allowance for loan losses, and a \$0.5 million increase in sinking fund income.

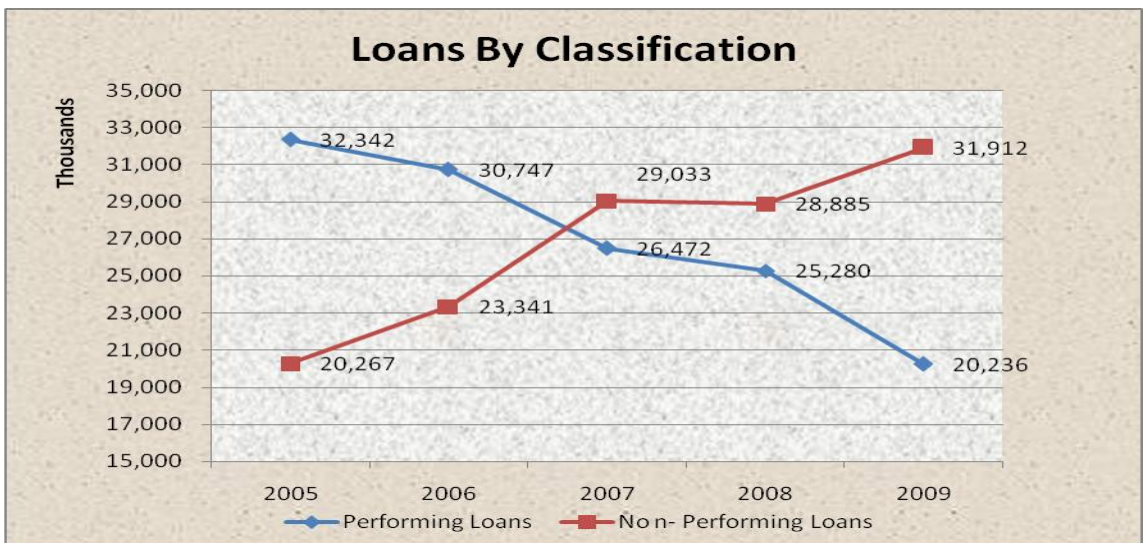
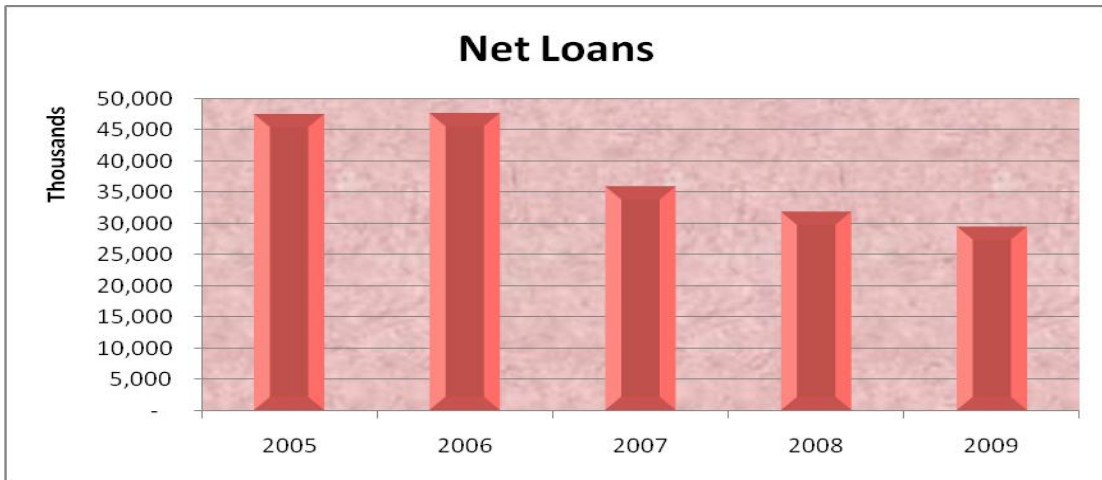


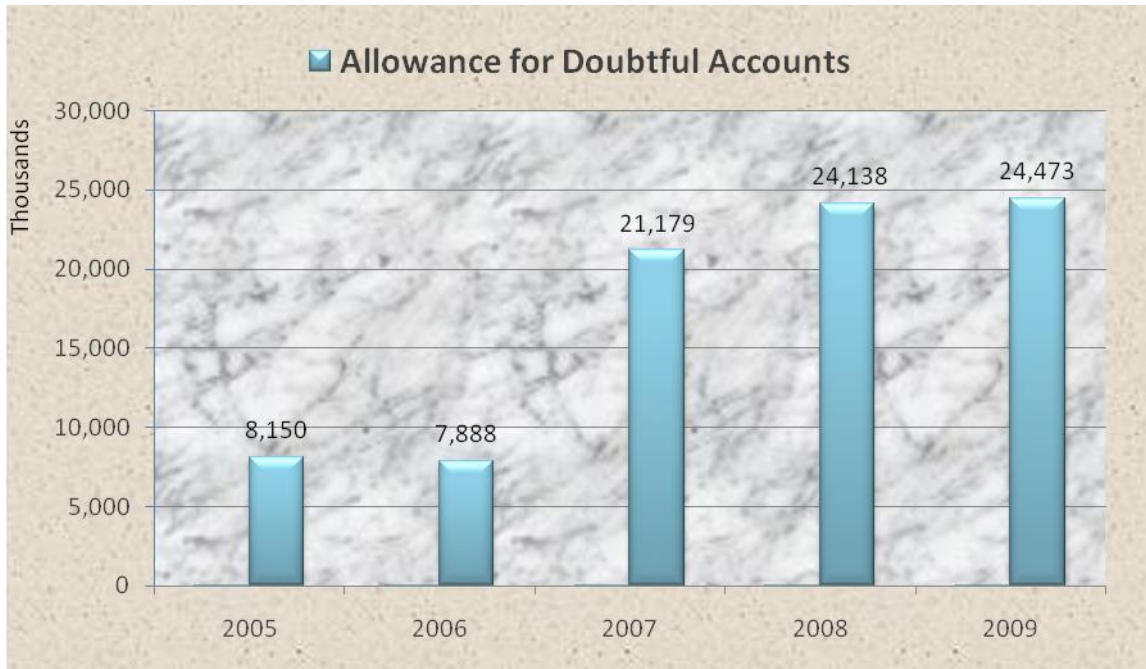
Net interest income (NII) has been decreasing over the past several years, reflecting the steady deterioration in the loan portfolio. The impact of the slowdown in the local economy was especially hard on the BDB, as the level of non-performing loans outpaced that of performing loans. Given the reduced level of business activity, many BDB clients experienced diminished sales volumes, closed their operations or simply stopped servicing their debts.

As reflected in the following graph, NII has been steadily declining, and in 2009 the cost of interest exceeded interest income. Loan interest income was \$2.5 million, down from \$3.2 million in the previous year. This decline of \$0.7 million, or 22%, is consistent with the 24% year-over-year decrease in performing loans.



At \$29.5 million, net loans were down \$2.3 million, or 7% from the previous year.





Direct contributions from the Government of the Bahamas for the interest rate subsidy averaged \$1.3 million over the last five years.

