MOODY'S INVESTORS SERVICE

CREDIT OPINION

30 December 2022

New Issue

Send Your Feedback

RATINGS

Coastline Credit Union Limited

Domicile	Australia
Long Term CRR	Not Assigned
Long Term Issuer Rating	Not Available
Type	Not Available
Outlook	Not Available

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

Analyst Contacts

Tanya Tang +61.2.9270.8123
Analyst
tanya.tang@moodys.com

Letitia Wong +61.2.9270.8182
Associate Analyst
letitia.wong@moodys.com

Patrick Winsbury +61.2.9270.8183
Associate Managing Director
patrick.winsbury@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

Coastline Credit Union Limited

New issuer

Summary

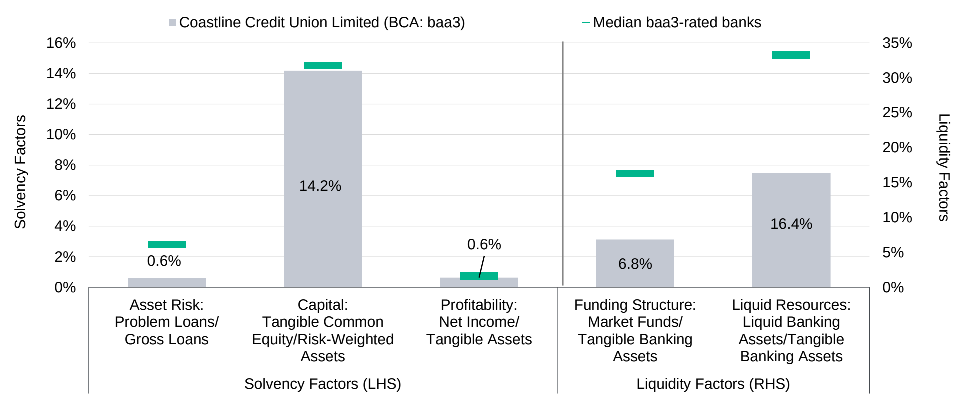
Coastline Credit Union Limited's (CCU) Baa3 long-term issuer rating reflects its strong risk profile, low problem loans ratio and and low credit costs to date, benefiting from its skew toward residential mortgages and conservative underwriting. However, its small scale and geographic concentration in a region whose economy is dominated by only a few industries is a risk, and point of differentiation to other higher-rated mutuals.

CCU maintains sound core capitalization, supported by strong profitability that reflects its franchise strength in its local market. However, its capitalisation has been at the low end of the range for the rated mutual peer group.

CCU will increase wholesale funding, particularly short-term wholesale deposits, on the back of slowing growth in retail deposits systemwide. But the increase will be modest and from a low base, given its ongoing focus on attracting retail deposits.

Exhibit 1

Rating Scorecard - Key financial ratios



Source: Moody's Financial Metrics™

Credit strengths

» Focus on low-risk assets and conservative underwriting

» Strong earnings

Credit challenges

» Small scale and geographic concentration

» Sound but weaker-than-peers core capitalization

Rating outlook

The stable outlook reflects our expectation that CCU's conservative underwriting and strong employment conditions will substantially offset the impact of inflationary pressures and rising interest rates on its loan book over the next 12-18 months.

Factors that could lead to an upgrade

» The credit union reduces its high geographic concentration while maintaining its conservative underwriting, including a track record of keeping its problem loan ratio well below 1%

» It maintains its tangible common equity ratio comfortably above 15%.

Factors that could lead to a downgrade

» Commercial and personal loans increase to more than 20% of total loans, geographic concentration increases, or its nonperforming loan ratio rises above 1.5% for an extended period

» Tangible common equity/risk-weighted assets ratio falls below 13%

» Market funds/tangible banking assets ratio rises to 30%

» Liquid asset coverage of unsecured wholesale debt maturities weakens to less than 100%

Key Indicators

Exhibit 2

Coastline Credit Union Limited (Consolidated Financials) [1]

	06-22[2]	06-21[2]	06-20[2]	06-19[2]	06-18[2]	CAGR/Avg.[3]
Total Assets (AUD Million)	797.9	718.1	623.9	538.0	503.0	12.2[4]
Total Assets (USD Million)	548.7	539.1	429.5	377.5	371.7	10.2[4]
Tangible Common Equity (AUD Million)	52.6	46.9	42.1	39.1	36.1	9.9[4]
Tangible Common Equity (USD Million)	36.2	35.2	29.0	27.5	26.7	7.9[4]
Problem Loans / Gross Loans (%)	0.2	0.3	1.2	0.6	1.0	0.7[5]
Tangible Common Equity / Risk Weighted Assets (%)	14.2	14.1	14.5	14.6	14.6	14.4[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	3.0	3.4	14.4	6.6	11.5	7.8[5]
Net Interest Margin (%)	2.7	2.5	2.4	2.5	2.5	2.5[5]
PPI / Average RWA (%)	2.3	2.1	1.7	1.8	1.8	1.9[6]
Net Income / Tangible Assets (%)	0.7	0.7	0.5	0.6	0.6	0.6[5]
Cost / Income Ratio (%)	64.8	66.8	71.6	70.4	69.8	68.7[5]
Market Funds / Tangible Banking Assets (%)	6.8	10.9	7.7	6.8	8.5	8.2[5]
Liquid Banking Assets / Tangible Banking Assets (%)	16.4	16.0	18.7	15.5	15.3	16.4[5]
Gross Loans / Due to Customers (%)	96.2	101.6	95.1	98.1	100.6	98.3[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; IFRS. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.

Sources: Moody's Investors Service and company filings

Profile

Coastline Credit Union Limited is a mutually owned authorized deposit-taking institution (ADI), with total assets of $798 million as of June 2022. Its loan book is primarily composed of Australian residential mortgages (89% of total loans as of August 2022) and complemented by small and medium-sized enterprises (SME) loans (11%) and minimal personal loans and reverse mortgages. The credit union focuses on the mid-north coastal region of Australia, particularly Port Macquarie-Hastings, Taree and Kempsey, while also seeking opportunities in surrounding areas, in particular Coffs Harbour and Foster. Its distribution channels comprise branch network, online and brokers.

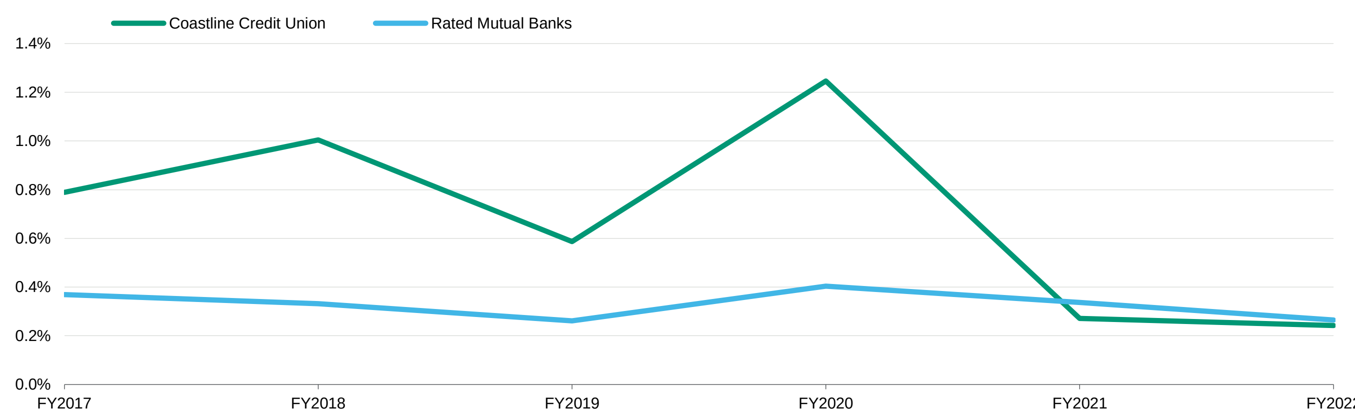
Detailed credit considerations

Focus on low-risk lending, but concentration risk remains

The credit union has kept its problem loans/gross loans well below 1% in most years (see Exhibit 3) and bad debt write-offs/gross loans at just a few basis points, benefiting from its skew toward residential mortgages – a generally low risk class in Australia – and conservative underwriting.

Exhibit 3

Low problem loan ratio; more volatile than peers



Sources: Company disclosures, Australian Prudential Regulation Authority (APRA) and Moody's Investors Service

For residential mortgages, CCU focuses on loans with principal and interest repayment terms (98% of mortgages as of August 2022), owner-occupier loans (80%), loan-to-value ratios (LVR) of no more than 80% (93%) and debt-to-income ratios lower than 6x (well below industry average in new lending flows). It applies prudent minimum serviceability buffers when assessing loan applications. Before October 2021, this minimum buffer was 2.5 percentage points over the actual loan rates, after which it increased to three percentage points, indicating the extent to which borrowers should be able to withstand interest rate increases. CCU has a lower risk appetite for first-time home buyers who tend to have built up less-than-average equity, and loans collateralized by apartments and units which tend to have more volatile prices than houses. Moreover, employment conditions are expected to remain generally strong, albeit an increase in the unemployment rate from a very low base is possible in 2023 and beyond.

For SME loans, CCU leverages its local market experience and focuses on loans with LVRs below 80% and strong collateralization, against the fact that most of these loans are to self-employed sole traders.

We expect this conservative underwriting will continue to buffer asset risks arising from higher inflation and a rising cash rate that have built pressure on household budgets and increased loan repayment costs. Further monetary policy tightening is possible in the months ahead. As rates have started to rise, housing prices have declined correspondingly, reducing the collateral cover on existing loans.

We view CCU as having a higher risk profile than other higher-rated mutuals because of its small scale and geographic concentration in a region whose economy is dominated by just a few industries. These factors contributed to volatility in its problem loans ratio during the coronavirus pandemic, with the ratio rising to 1.25% in the year ended 30 June 2020 (fiscal 2020), well above peers', and subsiding subsequently. This concentration will only reduce gradually amid Australia's expected slower credit growth environment and as the credit union expands in a measured way into surrounding areas.

These considerations underpin our downward adjustment to the Asset Risk and Business Diversification scores on our scorecard.

Sound capitalization, but lower than peers

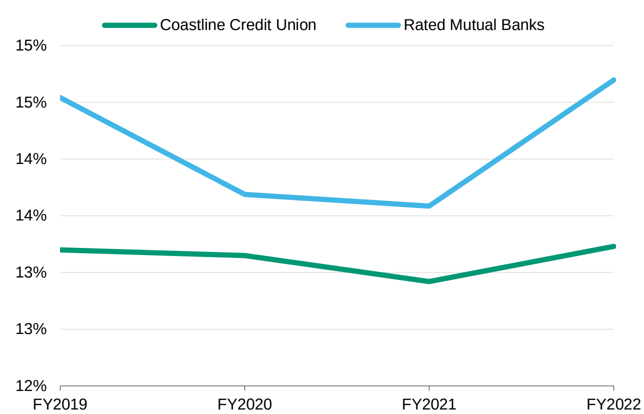
CCU has maintained its common equity tier 1 capital (CET1) ratio between 13% and 13.5% (Exhibit 4) over the 18 months to June 2022, and its tangible common equity (TCE) ratio between 14% and 15% (Exhibit 5). At these levels, the credit union has remained well above the regulatory requirement and within our expectations for its current rating, but at the low end of the range for its higher-rated peer group.

We expect CCU's core capital ratios to rise modestly on new capital rules to be implemented from 1 January 2023[1], and in an operating environment where credit growth is expect to slow and net interest margin (NIM) is expected to benefit from rising cash rates. Average rates on loans have increased by more than deposits since the cash rate started to rise in May 2022.

Exhibit 4

Sound CET1 ratio, albeit lower than peers

Common equity tier 1 capital/risk-weighted assets



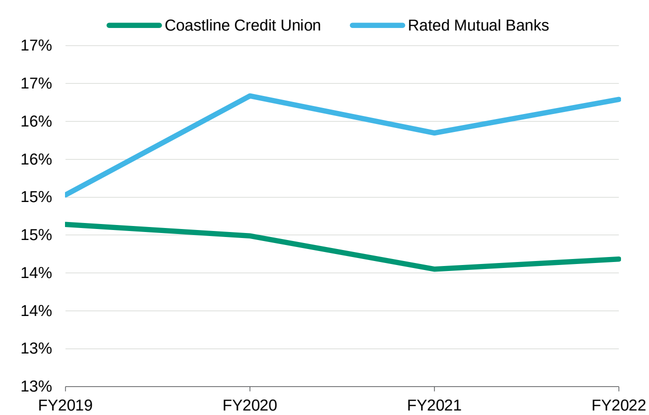
We use Tier 1 capital ratio as a proxy for CCU in FY2019 and FY2020

Sources: Company disclosures, APRA and Moody's Investors Service

Exhibit 5

Sound TCE, within rating expectations

Tangible common equity/risk-weighted assets



Sources: Company disclosures, APRA and Moody's Investors Service

On the other hand, CCU relies on retained earnings to accumulate core capital. The provision of mutual capital instruments enhances capital management flexibility, but the credit union has no immediate plans to issue such instruments. Limited capital raising capacity underpins a downward adjustment to the sub-score for Capital.

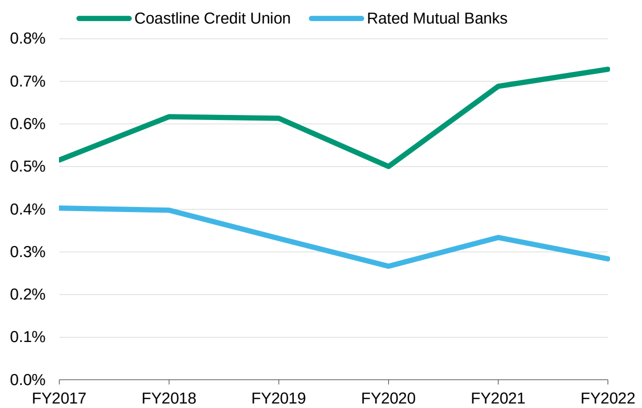
Stronger-than-peers earnings

CCU's profitability has outperformed rated mutual peers, reflecting its franchise strength in its local market. CCU's net income/total assets ratio was 0.7% as of June 2022, compared with 0.3% for peers (Exhibit 6). Constituent factors were stronger too as of the same date, with CCU's interest rate income/average interest earning assets at 3% compared with 2.7% for peers, NIM at 2.7% compared with 1.8% (Exhibit 7), and cost/income at 65% compared with 75%. The credit union's favorable cost/income ratio also reflects its efficiency improvement initiatives, largely offsetting substantial ongoing personnel expenses and IT investment to stay relevant to customers.

Exhibit 6

Stronger-than-peers profitability

Net income/tangible banking assets

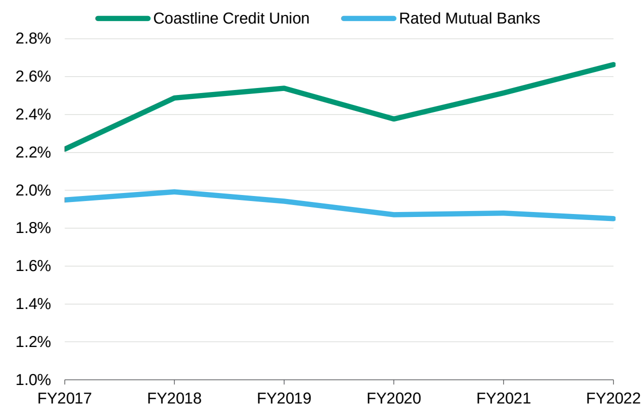


Sources: Company disclosures, APRA and Moody's Investors Service

Exhibit 7

NIM is stronger too

Net interest margin



Sources: Company disclosures, APRA and Moody's Investors Service

Non-interest incomes comprising fees and commissions from banking services will continue to be constrained, as has been the case across the country's banking industry, but this accounts for a small proportion of total revenue (about 12% as of June 2022).

Loan loss provisions have fallen from their precautionary high levels in response to the pandemic since fiscal 2021, although they may have to rise again in the rising rate environment.

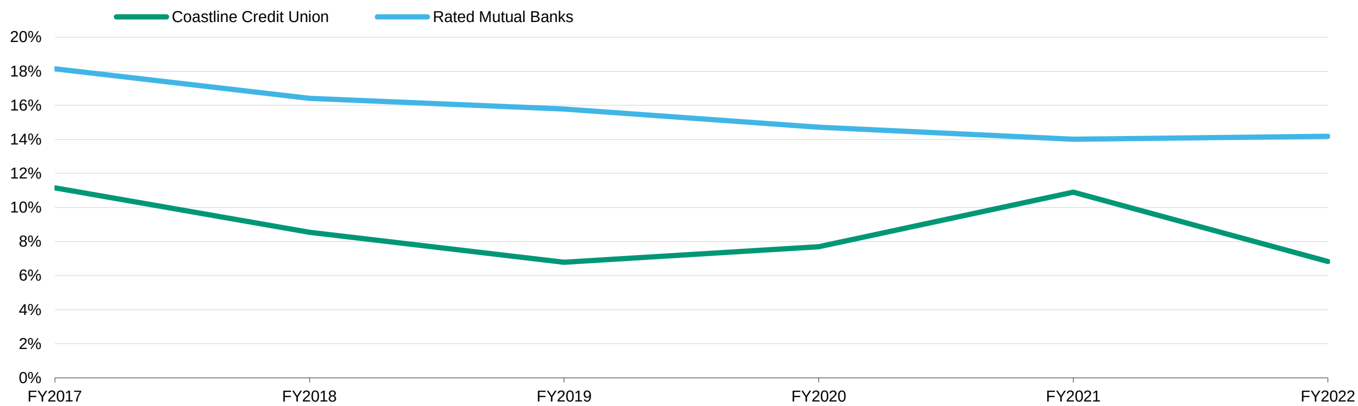
Wholesale funding will rise modestly from a low base, with ample liquidity

Retail deposits made up 93% of CCU's total funding as of June 2022, with wholesale deposits from financial institutions making up the remainder (Exhibit 8).

Exhibit 8

Wholesale funding use is lower than peers but expected to rise modestly

Market funds/tangible banking assets



Sources: Company disclosures, APRA and Moody's Investors Service

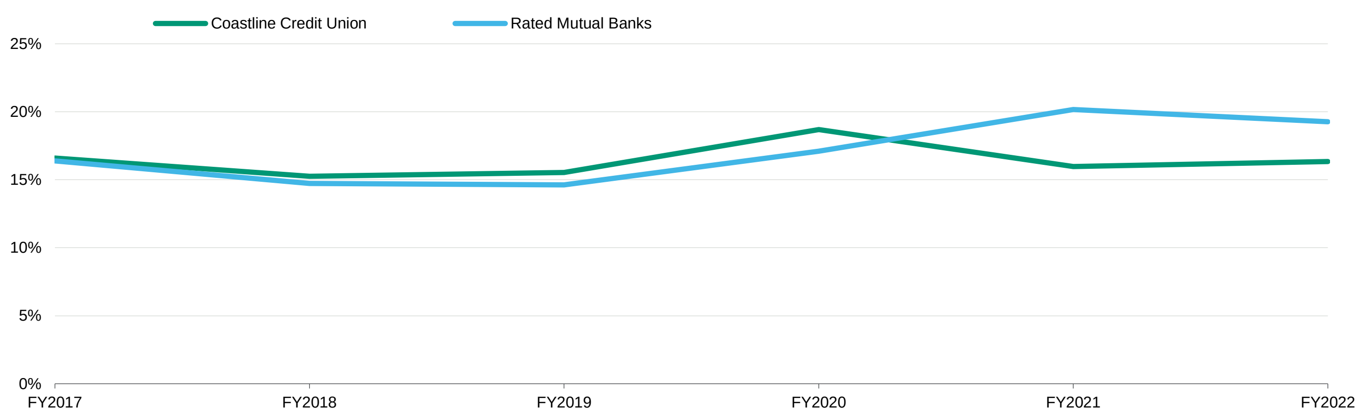
Future credit growth could be increasingly funded from wholesale sources as a result of the declining household savings ratio. But any increase in wholesale funding will be modest because CCU will continue to focus on retail deposits and is subject to regulatory limits -- short-term funding is capped at 15% of total funding.

CCU's has maintained its liquid assets at a substantial ratio of around 16% of tangible assets given its funding mix tilts toward retail funding (Exhibit 9). It has access to the emergency liquidity from the Credit Union Financial Support System Limited (CUFSS) and can draw from Reserve Bank of Australia's (RBA) Term Funding Facility (TFF) until September 2023, mitigating a lacking of internal residential mortgage-backed securities (RBMS) for the time being. Internal RMBS is repo-eligible with the RBA if liquidity needs arise.

Exhibit 9

Ample liquidity, in line with peers

Liquid assets/tangible banking assets



Sources: Company disclosures, APRA and Moody's Investors Service

CCU's rating is supported by Australia's Strong+ Macro Profile

Australia's Strong+ Macro Profile reflects the country's very high degree of economic robustness, institutional and government financial strength, and low susceptibility to event risk. Our baseline scenario projects a recovery in real GDP growth to 3.2% in 2022 and 1.9% in 2023, following 4.7% in 2021 and negative 2.2% in 2020.

A significant pick-up in inflation because of ongoing supply chain issues, rising global commodity prices and domestic supply factors has dampened economic sentiment, following the strong rebound in economic activity when pandemic restrictions were withdrawn. Tightening monetary policy is expected to counter surging inflation and moderate economic growth, with the former expected to peak in 2023. Labor markets remain tight with unemployment falling to 3.5% as at September 2022. Commodity prices are expected to moderate from their pandemic highs but remain favorable relative to historical averages, continuing to provide a tailwind to several key export industries. House prices have begun contracting from their peak in April 2022, after growing 16.7% in 12 months preceeding it and driving household debt/annualised disposable income back above pre-pandemic levels to 187% as of June 2022. Rising interest rates could reduce prepayment buffers built by residential mortgage borrowers or put some borrowers under financial pressure. However, low unemployment and low loan-to-value ratios on home loans, and small business loans which are typically secured by residential properties, should provide buffers to asset quality risk.

Australian banks' pricing power has historically been supported by the high level of concentration in the banking sector. NIMs are starting to recover as the RBA official cash rate rises from its record low reached during the pandemic. The RBA has increased the cash rate target by 300 basis points since May 2022, with further rate hikes expected in the year ahead. The rise in interest rates will be positive for banks' NIMs, as the increasing spread between loan yields and deposit costs will support margin expansion, however the cost of new market funding is on the rise, constraining some of this spread benefit. The benefit of higher interest rates will be more evident in fiscal 2023 and 2024-25 as fixed rate residential mortgages are refinanced at higher rates.

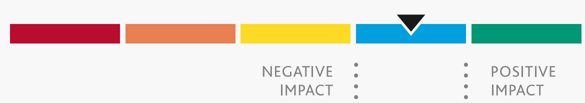
Australia's structural reliance on external financing remains a key vulnerability. Australian banks have been extending the term structure of their wholesale market funding for a number of years and pre-fund upcoming maturities well in advance. During the coronavirus pandemic, TFF displaced wholesale debt funding, but debt issuance has rebounded in 2022 and will remain strong in 2023-24 as banks look to refund their drawdowns under the TFF, and as deposit growth slows from its high pace during the pandemic. In its pandemic response, the RBA also increased its bond purchases and term-repo operations, boosting system-level liquidity. This substantial increase in high quality liquid assets has reduced the banking system's reliance on the RBA's committed liquidity facility, which will be phased out and withdrawn by 1 January 2023.

ESG considerations

Coastline Credit Union Limited's ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 10
ESG Credit Impact Score

CIS-2
Neutral-to-Low



For an issuer scored CIS-2 (Neutral-to-Low), its ESG attributes are overall considered as having a neutral-to-low impact on the current rating; i.e., the overall influence of these attributes on the rating is non-material.

Source: Moody's Investors Service

Coastline Credit Union Limited's ESG Credit Impact Score is neutral-to-low (**CIS-2**) reflecting the limited credit impact of environmental and social risk factors on the ratings to date and low governance risks.

Exhibit 11
ESG Issuer Profile Scores

ENVIRONMENTAL	SOCIAL	GOVERNANCE
E-2	S-4	G-2
Neutral-to-Low	Highly Negative	Neutral-to-Low

Source: Moody's Investors Service

Environmental

Coastline Credit Union Limited faces neutral-to-low environmental risks. The credit union's lower-than-industry-average environmental risk is driven by its limited exposure to carbon transition risks because its loan book is concentrated in Australian residential mortgages, with limited exposures to commercial loans. It has a large loan exposure to New South Wales, which face natural disasters captured under physical climate risk such as cyclones and floods that could damage homes. Nevertheless, this risk is largely mitigated by insurance cover and a track record of government assistance.

Social

Coastline Credit Union Limited is exposed to high industrywide social risks from customer relations (regulatory risk, litigation exposure and high compliance standards). A significant factor driving the assigned social risk score is the fact that banks typically hold large amounts of personal data, which makes data security and customer privacy protection important to them, and this importance has increased since the implementation of digitalization. In addition, Australia banking system is subject to a high level of scrutiny and accountability that heightens social risks from customer relations. As a mutual banking institution, the credit union is run for the benefit of the members and is focused on supporting the community from which its membership base is drawn. No incidences of mis-selling, misrepresentation or unfair customer treatment have been reported. Ongoing investment in technology will support the credit union in meeting the rising digital expectations of customers and strengthen data privacy. We see these attributes as positively offsetting the credit union's social risk exposure, and they are recognized in our "low governance risk" assessment.

Governance

Coastline Credit Union Limited faces low governance risks. The credit union's risk management policies and procedures are commensurate with its risk appetite, evident by its track record of strong asset quality and balance sheet strength, as well as its management of social risks. As a mutual, the credit union has a relatively simple organizational structure reflecting its domestic and retail-oriented franchise.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Support and structural considerations

Loss Given Failure analysis

Australia does not have a statutory bail-in framework. As a result, we do not consider Australia to have an operational resolution regime (as defined in our banks rating methodology). We apply a Basic LGF approach in rating Australian banks' junior securities.

To determine whether Australia has an operational resolution regime, we take both the current resolution framework and Australian policymakers' public stance into account. Although Australia is a member of the Financial Stability Board, which has highlighted the lack of statutory bail-in as a gap compared with international standards, the Australian authorities have so far adopted a more nuanced public stance on this issue.

On 2 December 2021, APRA released its final loss-absorbing capacity requirements for domestically important banks (D-SIB). This follows APRA's release, on 29 November 2021, of its final capital framework. The new rules raise the minimum CET1 ratio requirement to 10.25% from 8% for D-SIB, 9.25% from 7% for banks authorized to use their internal models to calculate RWA and 8% from 7%

for banks that use standardized RWA. APRA has chosen to raise the CET1 requirement by increasing the capital conservation buffer and setting the counter countercyclical buffer at 1%, which was previously set at 0%.

APRA's final loss-absorbing capacity requirements will add 4.5 percentage points to the minimum total capital requirements for D-SIBs - a 1.5 percentage point increase from the three percentage point interim requirement announced in 2019. This new requirement is likely to be met with Tier 2 capital.

Counterparty Risk (CR) Assessment

CCU's long-term/short-term CR Assessment is positioned at Baa2(cr)/P-2(cr)

CCU's long-term CR Assessment is positioned one notch above its Adjusted Baseline Credit Assessment (BCA) and consequently above the Preliminary Rating Assessment of senior unsecured debt obligations. This reflects our view that the probability of default on obligations that the CR Assessment represents is lower than that of senior unsecured debt. We believe that senior obligations are more likely to be preserved to limit contagion, minimize losses and avoid disruption of critical functions.

For CCU, the CR Assessment does not benefit from any government support in line with our support assumptions on senior unsecured debt. This reflects our view that operating activities and obligations reflected by the CR Assessment are unlikely to benefit from any support provisions from resolution authorities to senior unsecured debt.

Counterparty Risk Ratings (CRRs)

CCU's long-term/short-term CRRs are positioned at Baa2/P-2

CCUs long-term CRRs are positioned one notch above its Adjusted BCA and does not benefit from government support, in line with our support assumptions on senior unsecured debt.

Rating methodology and scorecard factors

Exhibit 12

Coastline Credit Union Limited

Macro Factors							
Weighted Macro Profile	**Strong +**	**100%**					
Factor		**Historic Ratio**	**Initial Score**	**Expected Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency							
Asset Risk							
Problem Loans / Gross Loans		0.6%	aa2	↔	a2	Quality of assets	Sector concentration
Capital							
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)		14.2%	a1	↓	a2	Access to capital	
Profitability							
Net Income / Tangible Assets		0.6%	baa2	↔	baa2	Return on assets	
Combined Solvency Score			a1		a3		
Liquidity							
Funding Structure							
Market Funds / Tangible Banking Assets		6.8%	aa3	↔	a3	Extent of market funding reliance	Expected trend
Liquid Resources							
Liquid Banking Assets / Tangible Banking Assets		16.4%	baa2	↔	baa2	Stock of liquid assets	
Combined Liquidity Score			a2		baa1		
Financial Profile					a3		
Qualitative Adjustments					Adjustment		
Business Diversification					-3		
Opacity and Complexity					0		
Corporate Behavior					0		
Total Qualitative Adjustments					-3		
Sovereign or Affiliate constraint					Aaa		
BCA Scorecard-indicated Outcome - Range					baa2 - ba1		
Assigned BCA					baa3		
Affiliate Support notching					0		
Adjusted BCA					baa3		

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Investors Service

Ratings

Exhibit 13

Category	Moody's Rating
COASTLINE CREDIT UNION LIMITED	
Outlook	Stable
Counterparty Risk Rating	Baa2/P-2
Bank Deposits	Baa3/P-3
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa3
Counterparty Risk Assessment	Baa2(cr)/P-2(cr)
Issuer Rating	Baa3
ST Issuer Rating	P-3

Source: Moody's Investors Service

Endnotes

1 The Australian Prudential Regulation Authority's new bank capital framework designed to embed "unquestionably strong" levels of capital and align Australian standards with the internationally agreed Basel III requirements will come into effect starting 1 January 2023. This framework strengthens financial resilience by being more risk sensitive through increasing capital requirements for higher lending risk and decreasing it for lower risks, among other things. This initiative benefits many mutual ADIs because of their lower-risk mortgage lending focus.

REPORT NUMBER 1353382

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

MOODY'S INVESTORS SERVICE