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CREDIT OPINION
28 December 2023

Update

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RATINGS

Coastline Credit Union Limited

Domicile	Australia
Long Term CRR	Baa2
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Not Assigned
Long Term Deposit	Baa3
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

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.

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Coastline Credit Union Limited

Update to credit analysis

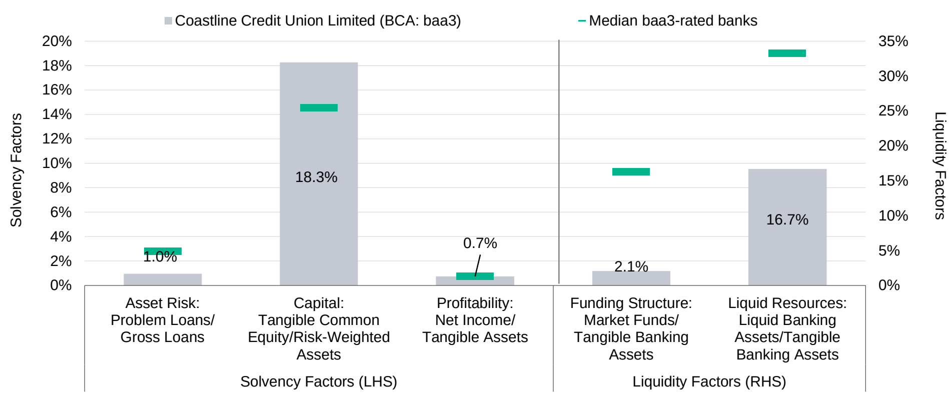
Summary

Coastline Credit Union Limited's (CCU) Baa3 long-term issuer rating reflects its focus on owner-occupier home loans with principal and interest repayments, providing a buffer against assets risks that may arise from an inflationary operating environment. CCU's geographic concentration in a compact region, coupled with its business lending, further contributes to these asset risks.

Following the implementation of revised capital rules[1], CCU enjoys a significantly higher core capital ratio. It plans to maintain a capital ratio that is notably higher than previous levels, even while accommodating credit growth and earnings pressures.

Its funding profile, which is centered on retail funding and complemented by short-term debt, is expected to remain stable for the next 12-18 months.

Exhibit 1
Rating Scorecard - Key financial ratios



Source: Moody's Financial Metrics™

Credit strengths

» Conservative underwriting of low-risk assets as a strategy to buffer against asset risks

» Strong capitalization as a safeguard against its credit loses

Credit challenges

» The inflationary environment, geographic concentration, and business lending contribute to asset risks

» Intensive competition and increased investments weaken the robust profit margin and earnings

Rating outlook

The stable outlook reflects our expectation that CCU will manage its credit risks over the next 12-18 months by maintaining prudent underwriting, and keep a strong capital level.

Factors that could lead to an upgrade

We could upgrade the bank's ratings if risks in the Australian housing sector subside, such as a significant decline in household debt, or a notable improvement in CCU's credit profile. This would be indicated by a reduced geographic concentration, maintenance of its conservative underwriting - including keeping its nonperforming loan/gross loans ratio largely steady and well below 1% - and a tangible common equity (TCE) ratio that remains comfortably above 15%.

Factors that could lead to a downgrade

We would downgrade CCU's ratings

» 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

» TCE ratio falls below 13%

» market funds/tangible banking assets rises to 30%, with substantial short-term funding component

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

Key Indicators

Exhibit 2
Coastline Credit Union Limited (Consolidated Financials) [1]

	06-23[2]	06-22[2]	06-21[2]	06-20[2]	06-19[2]	CAGR/Avg.[3]
Total Assets (AUD Million)	818.4	797.9	718.1	623.9	538.0	11.1[4]
Total Assets (USD Million)	544.8	548.7	539.1	429.5	377.5	9.6[4]
Tangible Common Equity (AUD Million)	59.3	52.6	46.9	42.1	39.1	10.9[4]
Tangible Common Equity (USD Million)	39.4	36.2	35.2	29.0	27.5	9.5[4]
Problem Loans / Gross Loans (%)	1.0	0.2	0.3	1.2	0.6	0.7[5]
Tangible Common Equity / Risk Weighted Assets (%)	18.3	14.2	14.1	14.5	14.6	15.1[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	10.7	3.0	3.4	14.4	6.6	7.6[5]
Net Interest Margin (%)	2.8	2.7	2.5	2.4	2.5	2.6[5]
PPI / Average RWA (%)	2.6	2.3	2.1	1.7	1.8	2.1[6]
Net Income / Tangible Assets (%)	0.8	0.7	0.7	0.5	0.6	0.7[5]
Cost / Income Ratio (%)	65.7	64.8	66.8	71.6	70.4	67.9[5]
Market Funds / Tangible Banking Assets (%)	2.1	6.8	10.9	7.7	6.8	6.9[5]
Liquid Banking Assets / Tangible Banking Assets (%)	16.7	16.4	16.0	18.7	15.5	16.6[5]
Gross Loans / Due to Customers (%)	91.9	96.2	101.6	95.1	98.1	96.6[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

CCU is a mutually owned authorized deposit-taking institution (ADI), with total assets of $818 million as of June 2023. Its loan book is primarily composed of Australian residential mortgages, which made up 86% of total loans as of June 2023. This is complemented by small and medium-sized enterprises (SME) loans (10%), and a minimal amount is allocated to 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 seeking opportunities in surrounding areas. Its distribution channels comprise a branch network, online platforms and brokers.

Detailed credit considerations

Conservative underwriting of low-risk assets as a strategy to buffer against asset risks

High inflation and interest rates, coupled with geographic concentration in a compact region, have adversely impacted CCU's asset quality and escalated its problem loan ratio to 1%, a figure higher than many other small mutual ADIs. Additionally, a significant portion of the credit union's outstanding fixed-rate loans could face a repayment shock when they are repriced from historically low rates to higher mortgage rates in 2024.

That said, any further rise in problem loans is likely to be moderated and remain within the expected range for the current rating, thanks to the country's robust employment conditions, despite the anticipation of a gradual increase in the unemployment rate from its current low level. Arrears will also be contained by the mortgage borrowers' accumulated loan prepayments. Moreover, the bank applies conservative underwriting standards, requiring a minimum serviceability buffer of 3 percent. This buffer is applied above the actual housing loan interest rate when assessing a borrower's repayment capacity at origination. As of 30 June 2023, 98% of the credit union's mortgages were principal and interest (P&I), approximately 80% were owner-occupied, and a negligible proportion were mortgages with a higher than 80% loan-to-value ratio. In the realm of SME loans, CCU capitalizes on its local market experience and focuses on loans with LVRs below 80%.

These considerations have been factored into the Asset Risk and Business Diversification sections of our scorecard.

Strong capitalization despite earnings pressures

The credit union's Common Equity Tier 1 (CET1) capital ratio was around 13%, and its TCE ratio was within the 14%-14.5% range, before the revised capital rules were implemented in January 2023. Both ratios were at the low end of the range for the peer group.

The revised bank capital framework boosted the credit union's CET1 ratio and TCE ratio to approximately 17% and 18% respectively in 2023. Moreover, CCU plans to maintain both ratios above 16%, a level more in line with the peer average. We nevertheless apply a downward adjustment to the Capital section in the scorecard, because the credit union relies on retained earnings to accumulate core capital, and its ability to raise additional core capital from the markets has not been tested.

To manage this desired capital ratio, CCU will balance credit growth and margin preservation, while its margin and net income may weaken somewhat from the current robust levels due to competition for quality loans and retail deposits, as well as more IT and operating investment to support business growth.

Ample liquidity to cover modest wholesale funding

Over recent years, CCU has largely matched its deposit and loan growth, resulting in a lower than 10% market funds to tangible assets ratio. The credit union could modestly increase the proportion of market funds as competition might cause deposit outflows. It can continue to rely on short-term wholesale deposits as it has not yet accessed long-term unsecured markets.

Its retail deposits mainly come from households, and about 70% of these are small-denomination accounts that are insured by the Financial Claims Scheme (FCS)[2], which supports granularity. About 60% of the bank's deposits are at-call deposits, including mortgage-linked offset accounts, transaction accounts, and long-term customer bonus-rate savings accounts. This suggests funding stability. The baa1 score assigned in our scorecard reflects our evaluation of the diversity and stability of the bank's funding.

CCU reported an adequate Minimum Liquidity Holding (MLH) ratio of 16% as of June 2023 and liquid assets to tangible assets ratio of 17%, relative to its large deposit base and small amount of wholesale debt. It has access to emergency liquidity from the Credit Union Financial Support System Limited (CUFSS), mitigating the impact of a lack of internal residential mortgage-backed securities (RBMS)[3].

CCU's rating is supported by Australia's Strong+ macro profile

Australia's Strong+ macro profile reflects the country's robust economic strength, institutions and governance strength, and low susceptibility to event risk. Our stance remains unchanged despite our baseline scenario suggests real GDP growth of 1.5% in 2023 and 1.3% in 2024, as higher interest rates constrain growth, before improving to 2% in 2025. Alongside this, we foresee a small uptick in the unemployment rate, rising from a very low level of less than 4%-4.5% in 2025. High levels of household debt remain a key economic vulnerability. As an indicator, household debt relative to income were high at 186.7% as of June 2023. High interest rates add to households' debt burden and reduce repayment buffers built by borrowers.

Despite this, the projected unemployment rate is considered strong by historical measures, and the banks' focus on low LVRs on home loans and small business loans, which are typically secured by residential properties, should provide buffers against asset-quality risk. National average house prices underwent a 9.1% drop from April 2022 to February 2023, but they have rebounded from the February trough.

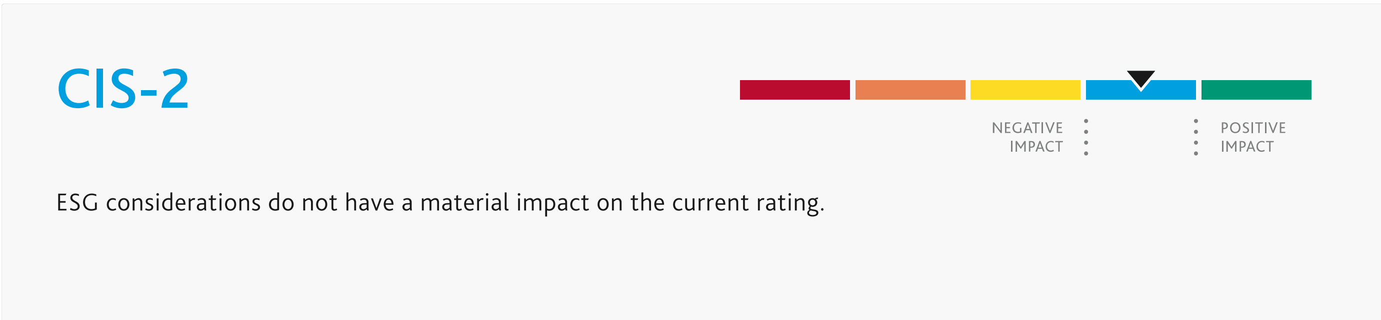
Australian banks' very strong pricing power has historically been supported by the high level of concentration in the banking sector. Higher interest rate has also helped improve banks' net interest margins. However, banks continue to repay the cheap funding provided by RBA and compete for retail deposits, and they accommodate customer preference for term deposits over at-call deposits. These factors could constrain further net interest margin gains from 2024 onwards.

Australia's structural reliance on external financing remains a key vulnerability. However, Australian banks have been extending the term structure of their wholesale market funding for a number of years and are pre-funding upcoming maturities well in advance.

ESG considerations

Coastline Credit Union Limited's ESG credit impact score is CIS-2

Exhibit 3
ESG credit impact score



Source: Moody's Investors Service

CCU's CIS-2 indicates that ESG considerations do not have a material impact on the current rating.

Exhibit 4
ESG issuer profile scores

Source: Moody's Investors Service

Environmental

CCU faces 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

CCU 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

CCU 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 (LGF) analysis

We apply a simple notching approach, known as Basic LGF, for Australian ADIs. When applying Basic LGF, we assume that banks not subject to an Operational Resolution Regime (ORR), which we expect to be resolved through bail-out, bankruptcy or ad hoc resolution measures.

The Preliminary Rating Assessment (PRA) represents our view of the expected loss of a given instrument without government support. The PRAs of CCU Bank's long-term deposit and senior unsecured debt are at the same level as its Adjusted BCA.

Government support considerations

We do not incorporate government support into rating for CCU, based on our assessment of the bank's systemic importance.

Counterparty Risk (CR) Assessment

CCU's CRA are Baa2(cr)/P-2(cr)

CCU's CRA does not benefit from government support and is therefore positioned one notch above its Adjusted BCA and consequently above the PRA 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 for senior unsecured debt. We believe that senior obligations that the CRA represents are more likely to be preserved to limit contagion, minimize losses and avoid disruption to critical functions

Counterparty Risk Ratings (CRRs)

CCU's CRRs Baa2/P-2

CCU's 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 5

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	1.0%	aa2	↔	a2	Quality of assets	Sector concentration
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	18.3%	aa2	↔	aa3	Access to capital	
Profitability						
Net Income / Tangible Assets	0.7%	baa2	↔	baa2	Return on assets	
Combined Solvency Score		aa3		a2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	2.1%	aa1	↔	baa1	Extent of market funding reliance	Expected trend
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	16.7%	baa2	↔	baa2	Stock of liquid assets	
Combined Liquidity Score		a1		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 6

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 was effective on 1 January 2023. This framework increases capital requirement for higher lending risk and decreases it for lower risks, among other things. This initiative benefits many mutual ADIs because of their lower-risk mortgage lending focus.

2 The FCS is an Australian government scheme that provides protection to deposit-holders with Australian incorporated banks, building societies and credit unions, and general insurance policyholders and claimants in the unlikely event that one of these financial institutions fails. The FCS is a government backed safety net for deposits of up to $250,000 per account holder per authorized deposit-taking institution (ADI). It also covers most general insurance policies for claims up to $5,000, eligible if they fulfil certain criteria. The FCS was established in 2008 and is administrated by the Australian Prudential regulation Authority (APRA). The government provides the initial funding to remove doubts regarding the sufficiency of FCS funding. Any shortfalls after liquidation would be recouped by an industry levy.

3 Internal RMBS is repo-eligible with the Reserve Bank of Australia (RBA) if liquidity needs arise.

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