

# MANAGEMENT DISCUSSION & ANALYSIS

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2017



COASTAL COMMUNITY  
CREDIT UNION

# Coastal Community Credit Union

## 2017 Management Discussion and Analysis

### About Coastal Community Credit Union

Providing services for over 70 years, parent company Coastal Community Credit Union (CCCU) is the largest Vancouver Island-based financial services organization and among the 25th largest credit unions in Canada when measured by asset size. CCCU provides personal, business and commercial banking services, complemented by its wholly-owned subsidiaries Coastal Community Insurance Services (2007) Ltd., which offers personal and commercial insurance solutions, and Coastal Community Financial Management Inc., which provides wealth management services through its Coastal Community Private Wealth Group division.

The Coastal Community\* family of companies serves Vancouver Island and the Gulf Islands, from Victoria to Port Hardy. With more than \$3.0 billion in total assets under management, CCCU operates a network of 23 branches, 16 insurance offices, four regional business service centres and one centralized contact centre with extended service hours. Coastal Community's experts offer caring and helpful service to meet all your financial and protection needs.

CCCU continues to help build healthier communities in part through donations, sponsorships, scholarships and fundraising efforts totaling over half-a-million dollars each year.

This Management Discussion and Analysis is prepared in conjunction with the audited consolidated financial statements. It is presented to provide management's overview of Coastal Community Credit Union's financial and operating performance which includes information on its wholly owned subsidiaries, Coastal Community Insurance Services (2007) Ltd., and its subsidiary Van Isle Insurance Services Ltd., and Coastal Community Financial Management Inc.

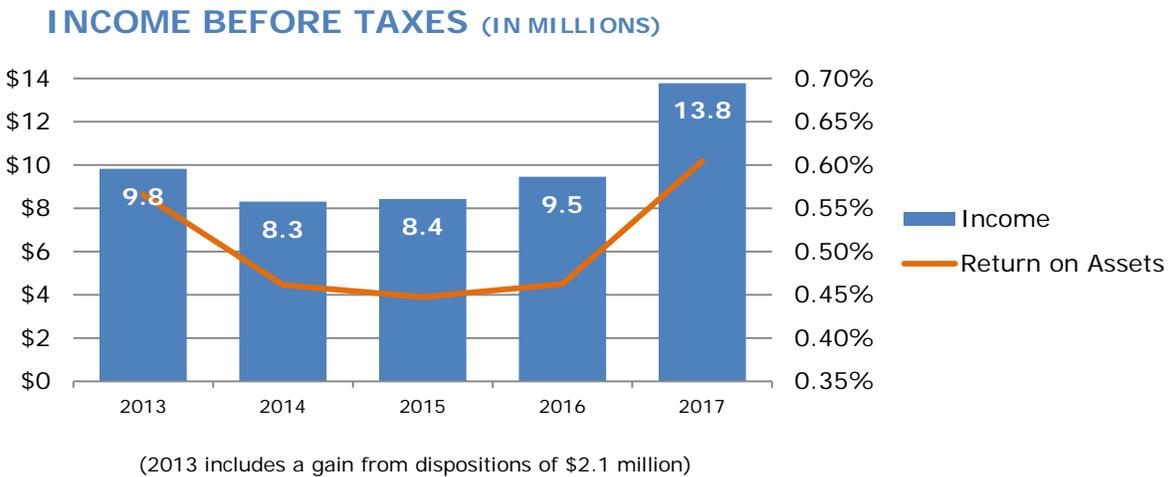
\*References to "Coastal Community" mean "Coastal Community Credit Union"

\*\*References to "insurance" refer to insurance services provided through Coastal Community Insurance Services (2007) Ltd., which is a wholly owned subsidiary of Coastal Community Credit Union

†References to "wealth management," "financial planning" and "investments" refer to the financial planning and investment services provided through Coastal Community Private Wealth Group, a division of Coastal Community Financial Management Inc., which is a wholly owned subsidiary of Coastal Community Credit Union



## 2017 Financial Performance



### Summary

For Coastal Community 2017 was a successful year with very strong financial results.

Loan balances grew a 12.0% matching last year's record growth while consolidated total assets surpassed \$2.4 billion. Deposit balances increased a solid 7.6% with the shortfall funded by securitization borrowings.

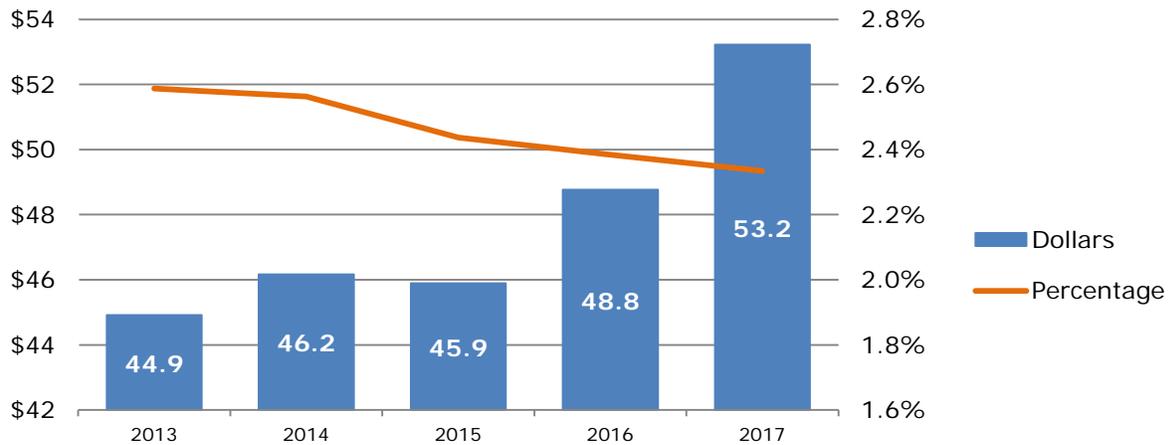
Consolidated income before taxes was \$13.8 million compared to \$9.5 million in 2016. Net interest income was significantly higher. Higher operating and loan impairment expenses were offset by an increase in other income. Consolidated net income, which is our consolidated income after taxes, was \$11.0 million.

Return on average assets improved considerably although net interest income compressed further due to the low interest rate environment.

Supported by our continued growth in the Victoria region, 2017's consolidated financial performance exceeded plan.



### NET INTEREST INCOME (IN MILLIONS)



### Net Interest Income

Net interest income is the largest source of revenue for Coastal Community. It represents the interest we earn on investments and member loans less the interest expense we pay on member deposits and borrowings. Net interest income increased to \$53.2 million largely due to higher loan volumes. The Bank of Canada increased its overnight target rate twice in 2017 which resulted in higher consumer and commercial lending rates. Deposit rates also increased, but to a lesser extent, while borrowing rates increased significantly. As a percentage of average assets, interest income fell 9 basis points, compared with the prior year; however interest expense declined only 4 basis points resulting in further compression of net interest income. Net interest income as a percentage of average assets declined from 2.38% in 2016 to 2.33% for 2017.

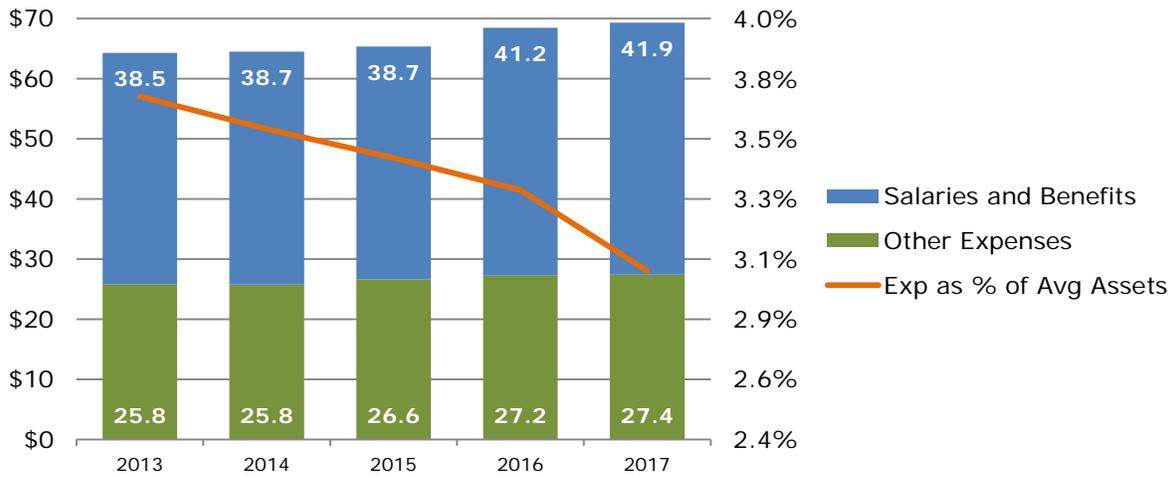
With rates forecast to increase further in 2018, we expect margin compression to ease.

### Other Income

Our strategy includes supplementing net interest income with diversified income sources including contributions from our insurance and wealth management<sup>†</sup> subsidiaries. Other income comprises loan fees, service charges, insurance and financial commissions, foreign exchange, dividends on investments<sup>†</sup>, and other miscellaneous revenues that are not interest related. In aggregate, other income increased \$1.5 million over last year primarily as a result of derivative income, higher loan fees, and other service income.



### OPERATING EXPENSES (IN MILLIONS)



### Operating Expenses

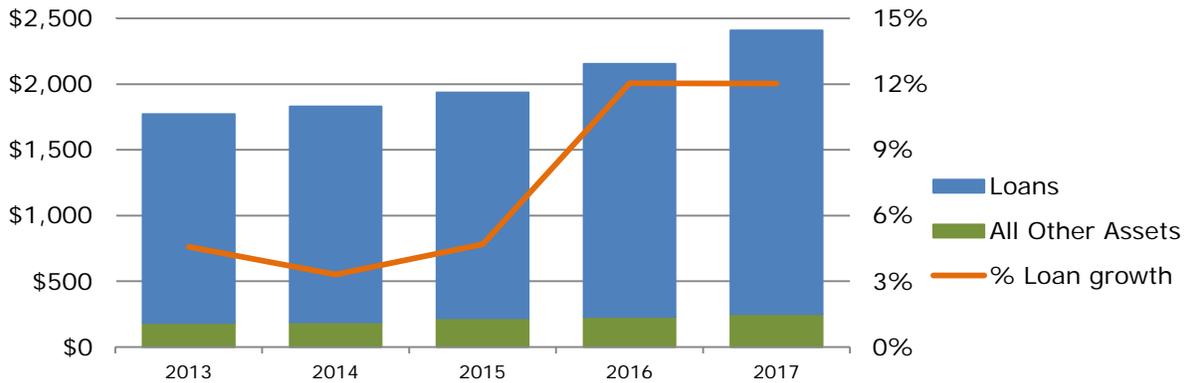
In an environment with declining interest income as a percentage of average assets, Coastal Community focuses on increasing efficiencies and innovating in order to help mitigate operating cost pressures. Salaries and benefits increased slightly in 2017; while regulatory costs increased and depreciation/amortization expense declined, resulting in overall operating expenses virtually unchanged from the prior year. Total operating expenses are well managed at 3.0% of average assets in 2017.

### Comprehensive Income

Comprehensive income includes the net income of the credit union and other comprehensive income or loss. Coastal Community utilizes derivatives for risk management. The unrealized gains or losses from the change in the fair value of these derivatives, if the hedging relationship is effective, are recorded in other comprehensive income or loss. The large gain recorded for 2017 reflects an improvement in the underlying markets. The cumulative unrealized gain or loss will net to zero when the derivative matures.



### ASSETS (IN MILLIONS)

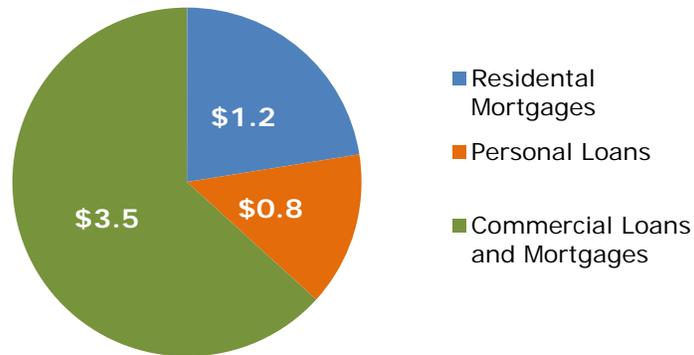


### Loans

Total assets increased from \$2.15 billion to \$2.41 billion. Member loans make up the largest proportion of total assets. We ended the year with a loan portfolio of \$2,156 million, up \$231 million or 12.0% compared to 2016. This equaled the record annual loan growth achieved in 2016. The majority of the growth was in residential mortgages. At December 31, 2017, residential mortgage loans totaled \$1,600 million growing by \$193 million compared to last year. The strong growth reflects the demand for housing in our trade areas. Personal loans ended the year at \$98 million declining \$12 million compared to 2016. Commercial loans grew by \$51 million to \$460 million.



## ALLOWANCE FOR IMPAIRED LOANS (IN MILLIONS)



### Allowance for Impaired Loans

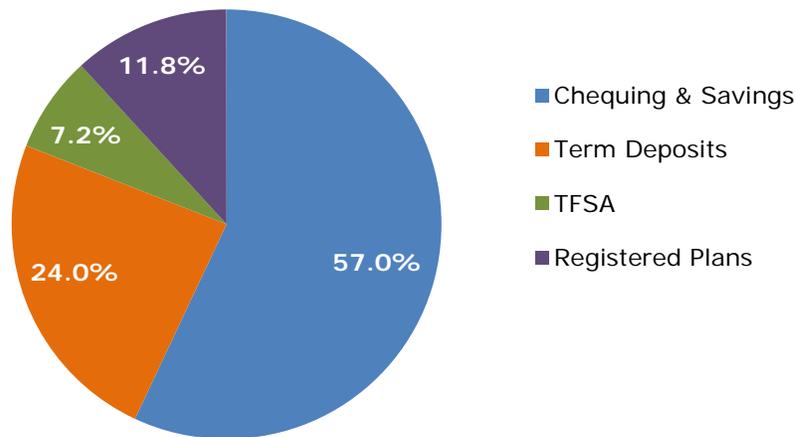
The allowance for impaired loans increased to \$5.5 million from \$4.0 million in 2016. At December 31, 2017 the allowance for impaired loans consisted largely of commercial loans and mortgages, with a smaller proportion of residential mortgages and personal loans.

The total allowance for impaired loans at December 31, 2017 represents 0.25% of total loans which is higher than one year earlier. The allowance for individually impaired loans declined, however the collective allowance was increased from the prior year. The collective allowance helps to mitigate future loan losses that may result from changes in the economic environment and other risk factors.

The Credit Union regularly reviews its loan portfolios for impairment and recommends specific loans to be written off where recovery of the debt is deemed unlikely. Loans written off declined to \$0.3 million in 2017 compared to \$0.4 million in 2016. Loan impairment expense recognized in 2017 increased over the prior year reflecting an increase to the allowance. A complete analysis of our allowance for impaired loans is provided in Note 8 of the audited consolidated financial statements.



## DEPOSIT MIX



### Deposits

Member deposits are the largest component of liabilities. Deposits grew by 7.6% or \$150 million to \$2,114 million in 2017. This was the second highest annual deposit growth in the Credit Union's history. Chequing and savings accounts hold the largest proportion of member deposits. We were successful in increasing the proportion of term deposits our members hold with us by providing personalized expert advice.

Tax-Free Savings deposit products include a high interest savings account and a full suite of term deposits. Registered plans include RRSPs, RRIFs, RDSPs and RESPs.

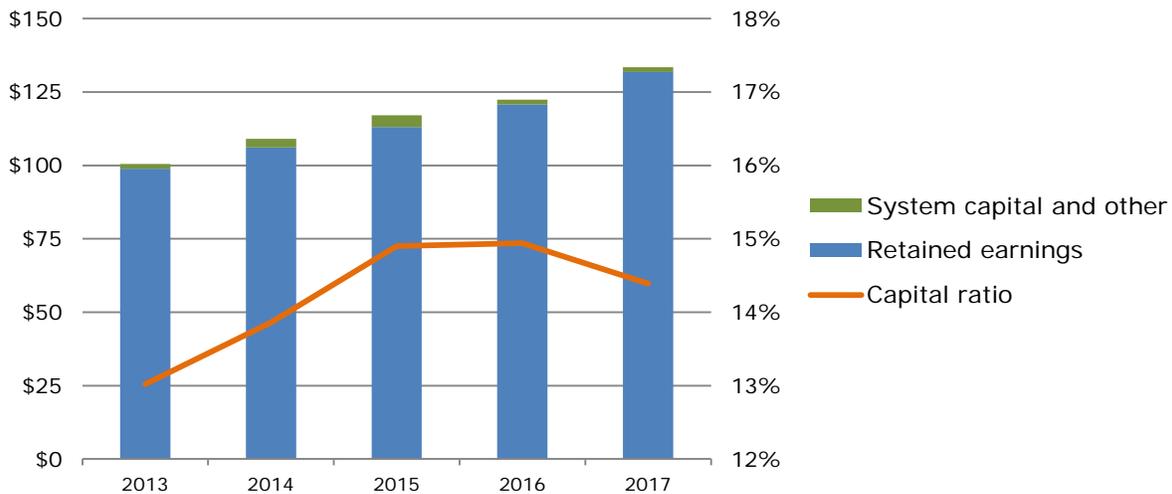
### Borrowings

The Credit Union maintains operating lines of credit with Central 1 Credit Union and another financial institution. Access to borrowing facilities is an important part of effective liquidity management. Outstanding short-term borrowings declined by \$2 million at December 31, 2017.

During the year Coastal Community also participated in the Canada Mortgage Bond program by selling mortgages to third parties in order to fund mortgage growth. At the end of the year the carrying amount of secured borrowings was \$92 million.



## CAPITAL (IN MILLIONS)



### Retained Earnings and Capital

Retained earnings, which represent the main source of capital for Coastal Community Credit Union, grew by \$11.0 million to \$131.8 million in 2017. A strong and stable capital base provides security against unexpected events and supports our ongoing growth. Increased capital allows us to pursue new initiatives including enhanced service to members and clients as well as the expansion into the Capital region. Capital management objectives are to maintain a capital base that is structured to exceed regulatory requirements and to best utilize capital allocations. To ensure processes are in place to meet these objectives, Coastal Community follows policies approved by the Board of Directors. Management monitors capital levels on a regular basis.

Capital requirements are regulated by the Financial Institutions Commission of BC (FICOM). A minimum ratio of capital to risk-weighted assets of 8.0% must be maintained. Coastal Community Credit Union's capital adequacy ratio at December 31, 2017 declined to 14.39% from 14.94% in 2016.

### Risk Management

The Board of Directors has overall responsibility for the establishment and oversight of the Credit Union's Enterprise Risk Management (ERM) framework. This responsibility includes approving the ERM framework and the policies that comprise that framework and setting the organization's risk appetite. In addition to the risks identified in Note 21 of the audited consolidated financial statements, the Credit Union is also exposed to operational, strategic, legal, regulatory, and reputational risk. Coastal Community Credit Union has a solid framework in place that identifies and addresses these risks and maintains systems of internal accounting and administrative controls of high quality, consistent with reasonable cost. These systems are designed to provide reasonable assurance that the financial information is relevant, reliable and accurate, and that the Credit Union's assets are appropriately accounted for and adequately safeguarded.



## 2018 Outlook

Looking ahead to 2018, the Credit Union expects net interest income compression to slow as rates rise, market competition to intensify further and funding options to increase in importance. Member loan and deposit growth are expected to remain strong as our branches in the Capital Regional District expand their member base and all market areas experience population migration.

Coastal Community Credit Union has been an established Vancouver Island company for over 70 years. Along with being the largest Island-based credit union and 100% Island operated, Coastal Community remains one of the top ten largest credit unions in British Columbia when measured by asset size. The key aspects that set Coastal Community apart from the rest are our integrated approach to providing expert financial advice and personalized solutions across all of our business lines and our 100% Island focus. Our vision to improve financial health, enrich people's lives and build healthier communities will allow us to continue to do *Great Things* well into the future.