

# MANAGEMENT DISCUSSION & ANALYSIS

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2020



COASTAL COMMUNITY  
CREDIT UNION

# Coastal Community Credit Union

## 2020 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 22 largest credit unions in Canada when measured by asset size. CCCU provides personal, business and commercial banking services, complemented by its wholly-owned subsidiary Coastal Community Financial Management Inc., which provides wealth management services through its Coastal Community Private Wealth Group division, and its 50% equity interest in 1200089 BC Ltd. that owns two subsidiaries which offer personal and commercial insurance solutions.

The Coastal Community\* family of companies serves Vancouver Island and the Gulf Islands, from Victoria to Port Hardy. With more than \$3.9 billion in total assets under management, CCCU operates a network of 24 full-service locations 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 in retail banking, regional business services, insurance\*\*, wealth management†, trust and estates\*\*\*.

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 subsidiary, Coastal Community Financial Management Inc. and its 50% equity interest in 1200089 BC Ltd., a joint venture that owns Coastal Community Insurance Services (2007) Ltd. and Interior Savings Insurance Services Inc.

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

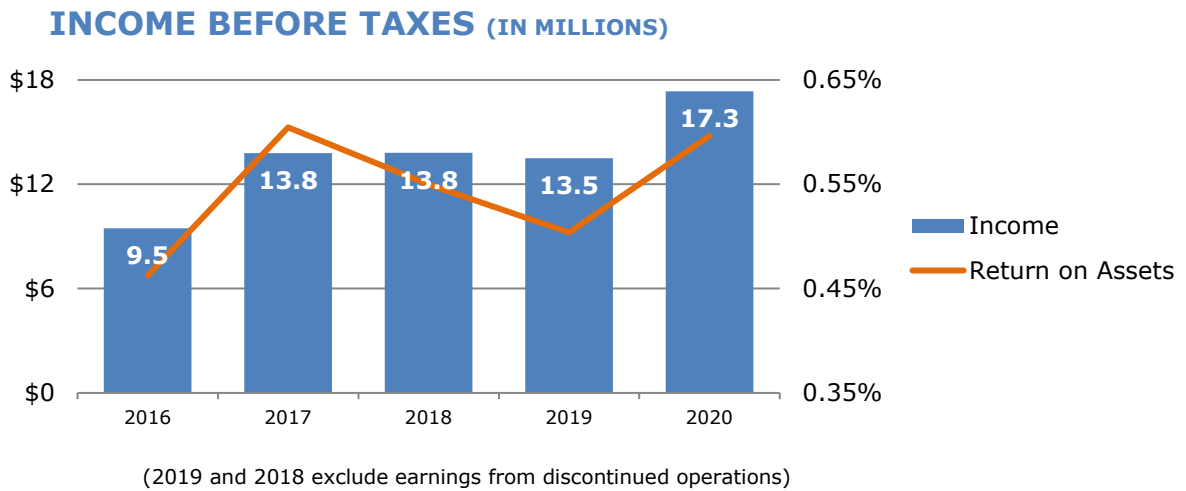
\*\*References to "insurance" refer to insurance services provided through Coastal Community Insurance Services (2007) Ltd., which is a wholly owned subsidiary of 1200089 BC Ltd, a joint venture that also owns Interior Savings Insurance Services Inc.

†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

\*\*\*Trust and Estate services provided through Concentra Trust, a wholly-owned subsidiary of Concentra Bank.



## 2020 Financial Performance



### Summary

2020 was a strong year for Coastal Community despite the challenges of the global pandemic.

Loan balances increased marginally however cash and investments grew significantly pushing consolidated total assets to more than \$3.08 billion. Deposit balances increased a record-breaking 14.7% as our members built up their savings due to reduced spending, government programs and uncertainty.

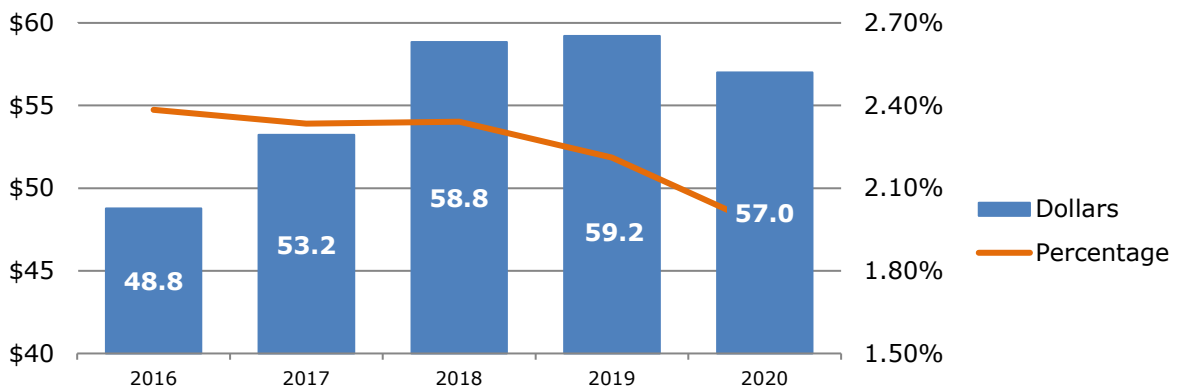
Consolidated income before taxes was \$17.3 million compared to \$13.5 million in 2019. While income before taxes does not include earnings from discontinued operations, for 2020 it included a \$4.3 million gain due to the transition of our mandatory liquidity pool to a new structure effective January 1, 2021. Lower financial margin was offset by lower operating expenses. Loan impairment reflected a larger provision. Consolidated net income, which is our consolidated income after taxes, was \$14.9 million.

Return on average assets, excluding discontinued operations, improved from 50 to 60 basis points.

2020's consolidated financial performance finished well ahead of plan.



### NET INTEREST INCOME (IN MILLIONS)



### Net Interest Income

Net interest income, the largest source of revenue for Coastal Community, represents the interest we earn on investments and member loans less the interest expense we pay on member deposits and borrowings. Net interest income declined to \$57.0 million. The Bank of Canada overnight target rate fell 1.50% reducing our Prime rate by the same amount and thereby the interest earned on variable rate loans. Fixed consumer and commercial lending rates declined significantly as did term deposit rates. Demand deposit rates also declined but had less room to fall. Slow loan growth compounded by high deposit growth resulted in substantial excess liquidity. As a percentage of average assets, interest income shrank 43 basis points over the prior year with interest expense decreasing only 18 basis points. As a result, net interest income as a percentage of average assets decreased from 2.21% in 2019 to 1.96% for 2020.

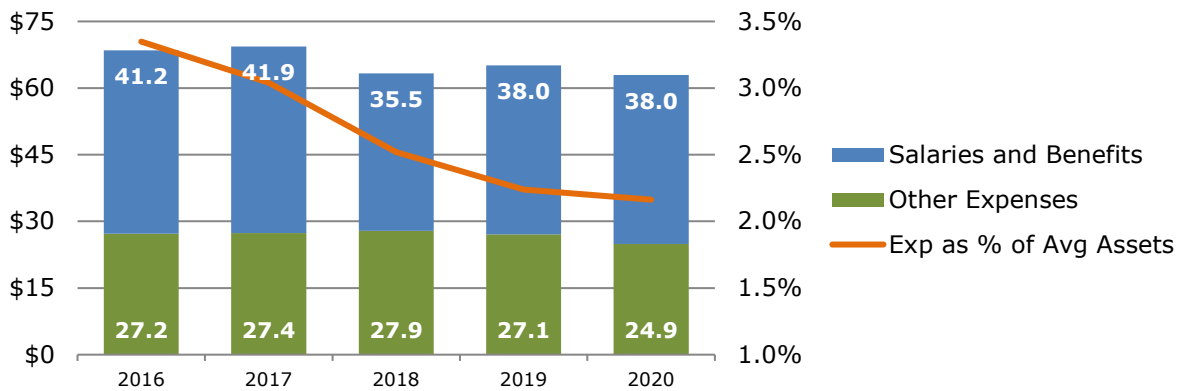
As rates start to rise in 2021, in anticipation of the vaccine and a better economic outlook, we expect net interest income as a percentage of average assets to improve.

### Other Income

Our strategy includes supplementing net interest income with diversified income sources including contributions from our wealth management subsidiary and equity interest in a joint venture that owns two insurance subsidiaries. Other income comprises loan fees, service charges, insurance and financial commissions, foreign exchange, dividends on investments, and other miscellaneous revenues that are not interest related. Other income was higher than the prior year due to a modification gain of \$4.3 million on deposits held as investments with Central 1 Credit Union, in anticipation of a transition to a new statutory liquidity structure on January 1, 2021. Further details of the transition are provided in Note 26, *Subsequent Event* in the audited consolidated financial statements.



## OPERATING EXPENSES (IN MILLIONS)



### Operating Expenses

In an environment with downward pressure on net interest income as a percentage of average assets, Coastal Community focuses on increasing efficiencies and innovating in order to help mitigate operating cost pressures. Growing our operations and investing in technology contributed to higher data processing costs in 2020. Salaries and benefits remained constant year over year during the COVID-19 global pandemic while other operating expenses and administration decreased.

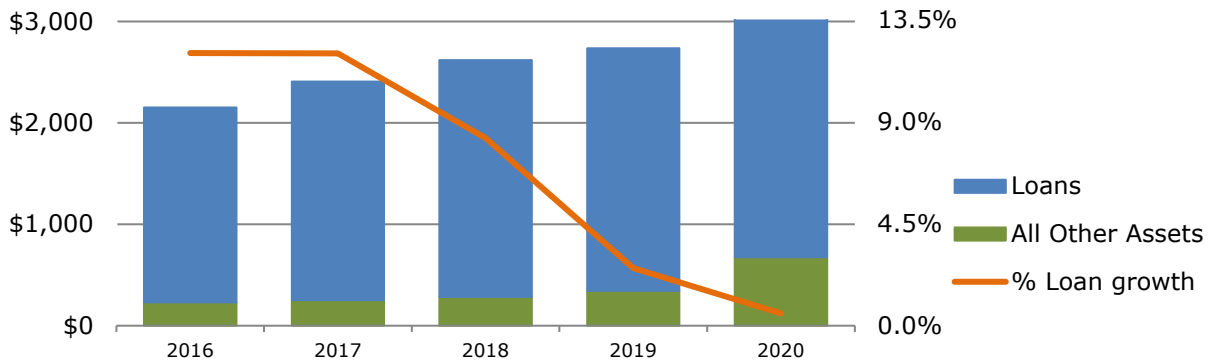
Overall, total operating expenses as a percentage of average assets held steady at 2.2%.

### 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 loss recorded for 2020 reflects a deterioration in the underlying markets. The cumulative unrealized gain or loss will net to zero when the derivative matures.



### ASSETS (IN MILLIONS)

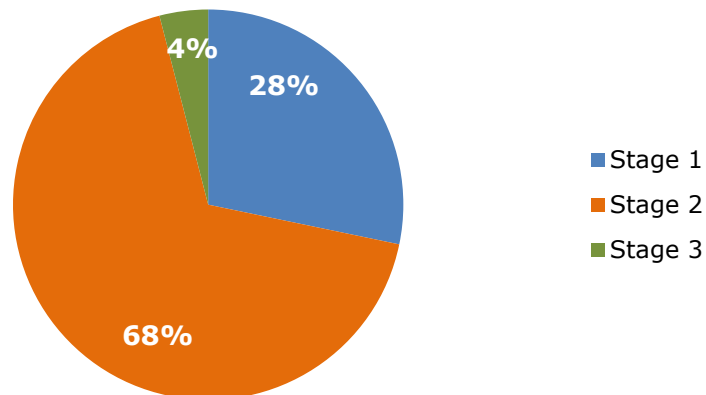


### Loans

Total assets increased from \$2.74 billion to \$3.08 billion or by 12.6%. Member loans make up the largest proportion of total assets even with the large increase in cash and investments in 2020. We ended the year with a loan portfolio of \$2,406 million, up \$13 million or .5% over 2019. Loan activity was significantly impacted by the pandemic. The majority of the growth was in commercial loans. At December 31, 2020, commercial loans totaled \$592 million growing by \$16 million compared to last year. Personal loans ended the year at \$68 million declining \$12 million compared to 2019. Residential mortgage loans grew \$11 million to \$1,749 million.



## ALLOWANCE FOR CREDIT LOSSES



### **Allowance for Credit Losses**

The expected credit loss ("ECL") model results in an allowance for credit losses being recorded on financial assets regardless of whether there has been an actual impairment. The model requires the recognition of credit losses based on up to 12 months of expected losses for performing loans (Stage 1) and the recognition of lifetime expected losses on performing loans that have experienced a significant increase in credit risk since origination (Stage 2) and credit impaired assets (Stage 3).

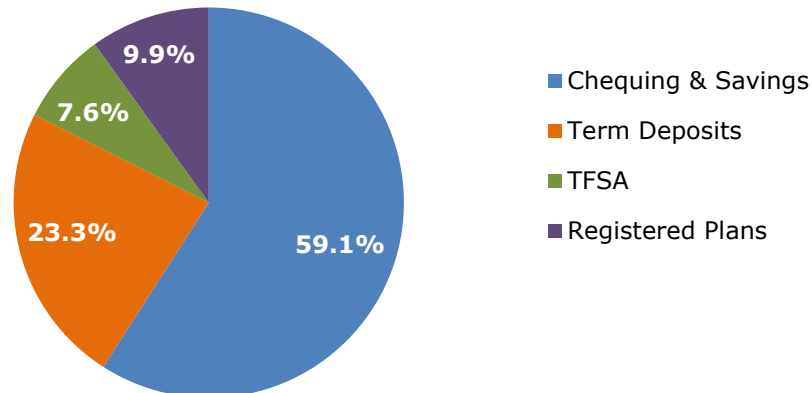
The allowance rose to \$7.0 million compared to \$5.3 million at the end of 2019 with the proportion in Stage 2 increasing the most.

The total allowance at December 31, 2020 represents 0.29% of total loans which is higher than the 0.22% for 2019.

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. 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 a record 14.7% or \$348 million hitting almost \$2,715 million at the end of the year. Exponential growth was experienced across the financial services sector as Canadians increased their savings due to the pandemic. Chequing and savings accounts increased the most as our members chose to keep their funds accessible. For the same reason, we saw a decrease in the proportion of deposits held in Term Deposits.

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

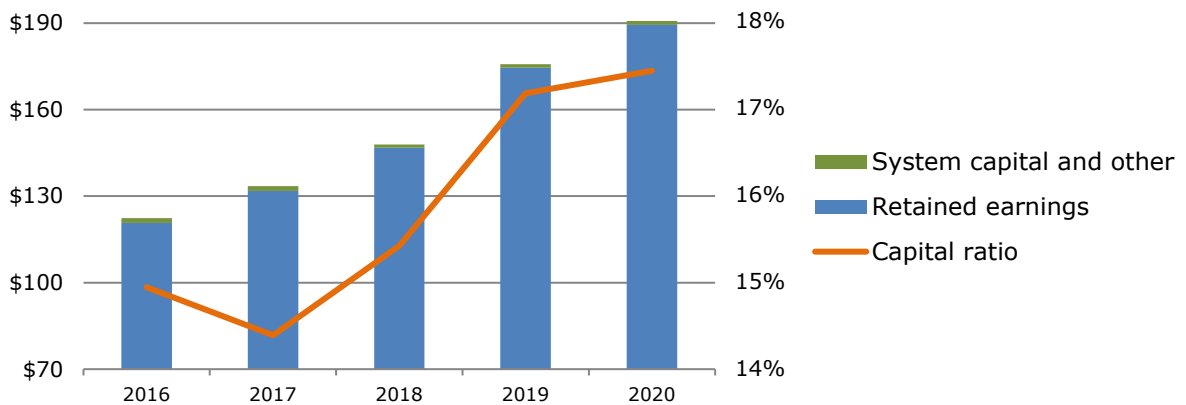
The Credit Union maintains operating lines of credit with Central 1 Credit Union and another financial institution. Access to borrowing facilities is an important part of effective liquidity management. Outstanding short-term borrowings remained at zero as of December 31, 2020.

During the year, Coastal Community did not participate in the Canada Mortgage Bond program as we had significant excess liquidity. At the end of 2020, the carrying amount of secured borrowings declined to \$132 million.





## CAPITAL (IN MILLIONS)



### Retained Earnings and Capital

Retained earnings, which represent the main source of capital for Coastal Community Credit Union, grew by \$14.9 million to \$189.5 million in 2020. 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 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 BC Financial Services Authority (BCFSA). 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, 2020 improved from 17.17% to 17.43%.

### 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.



## 2021 Outlook

Looking ahead to 2021, the Credit Union expects net interest income to improve as longer-term rates increase and members' accumulated savings are drawn down. While market competition for loans will continue, loan growth is expected to increase compared to 2020 as our branches in the Capital Regional District expand their member base and all market areas experience continued population migration.

The timing of the COVID-19 vaccine and reopening of the economy will directly impact market expectations and future rate hikes. The Credit Union continues its focus on the financial health and safety of its members and clients during this transition time.

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.