

# Coastal Community Credit Union

## 2019 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 \$3.5 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"

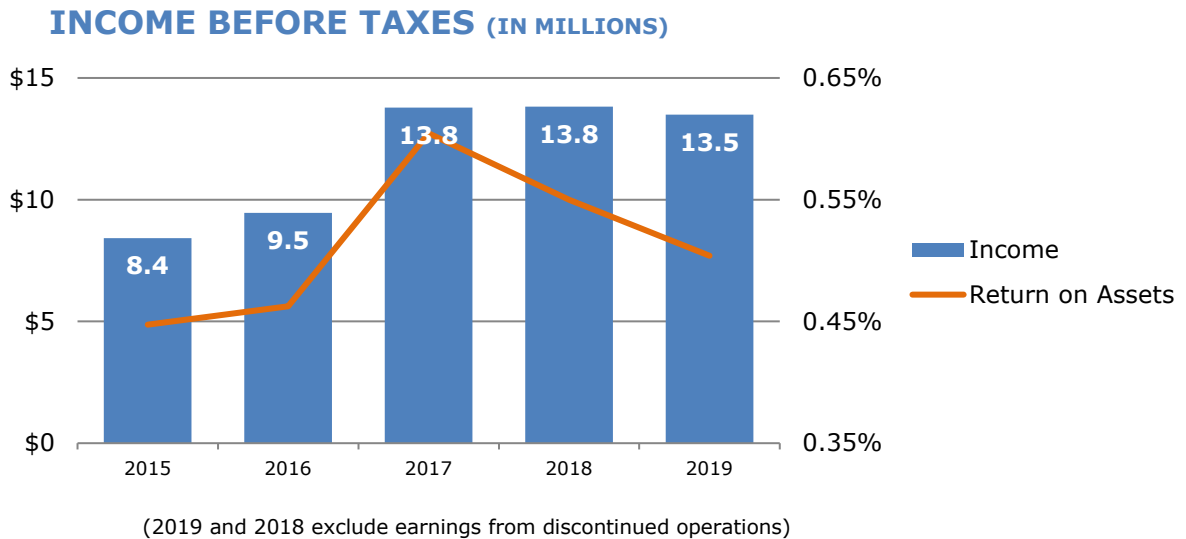
\*\*References to "insurance" refer to insurance services provided through Coastal Community Insurance Services (2007) Ltd., which is a wholly owned subsidiary of 1200089 BC Ltd, a joint venture that also owns Interior Savings Insurance Services Inc.

†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.



## 2019 Financial Performance



### Summary

2019 was a strong year for Coastal Community.

Loan balances increased by 2.5%, following several years of significant growth, pushing consolidated total assets to more than \$2.7 billion. Deposit balances increased a healthy 5.0% with the excess funding reducing borrowings and providing additional liquidity.

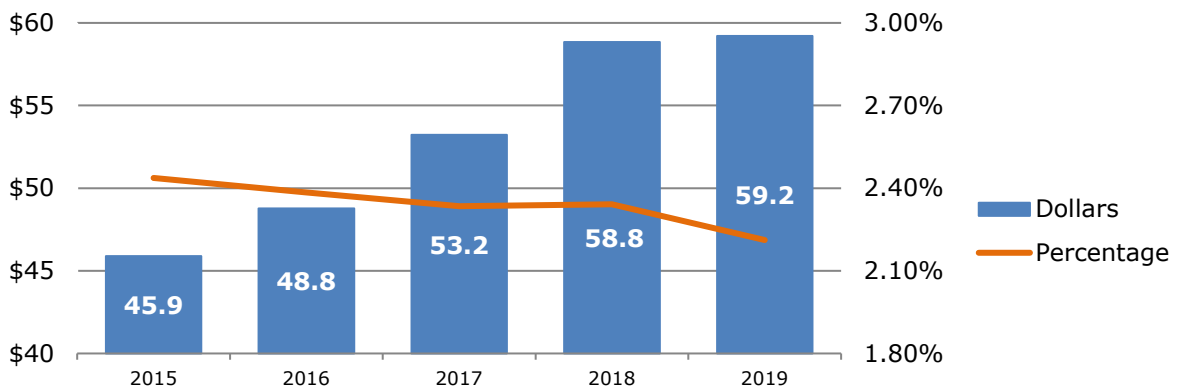
Consolidated income before taxes was \$13.5 million compared to \$13.8 million in 2018. Income before taxes does not include earnings from discontinued operations. For comparability, 2018 numbers were restated to reflect discontinued operations. Coastal's wholly owned subsidiary Coastal Community Insurance Services (2007) Ltd. was sold to 1200089 BC Ltd. a joint venture owned 50% by Coastal. Earnings from discontinued operations include a gain from disposition of \$16.1 million for 2019 and \$1.2 million for 2018. Operating expenses were higher but well controlled. Loan impairment reflected a recovery again this year. Consolidated net income, which is our consolidated income after taxes, was \$27.8 million.

Return on average assets, excluding discontinued operations, declined from 55 to 50 basis points.

2019's consolidated financial performance was 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 increased slightly to \$59.2 million. The Bank of Canada overnight target rate was unchanged however, fixed consumer and commercial lending rates declined significantly. Deposit rates fell by a lesser extent, while borrowing rates remained the same. As a percentage of average assets, interest income improved 10 basis points over the prior year with interest expense increasing 23 basis points. As a result, net interest income as a percentage of average assets decreased from 2.34% in 2018 to 2.21% for 2019.

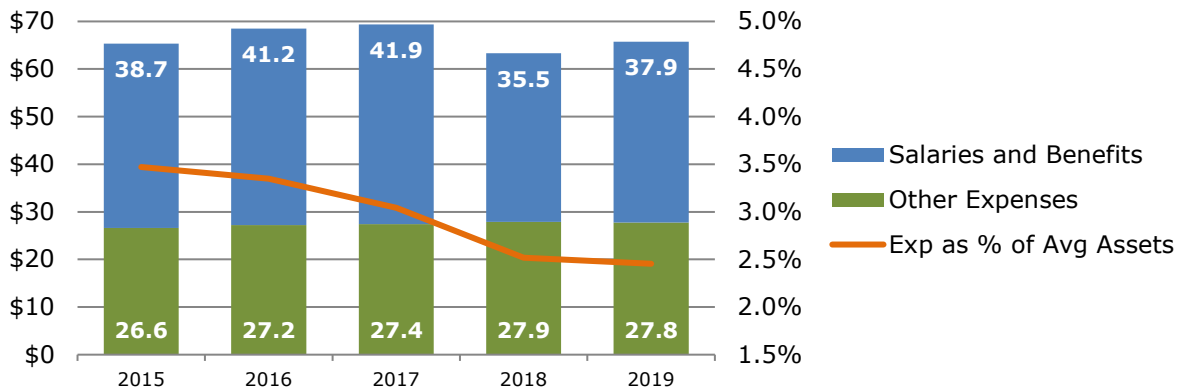
With continued loan and deposit pricing pressure, we expect net interest income as a percentage of average assets to decline further in 2020.

### 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 slightly higher than the prior year (the latter being restated for discontinued operations.)



### 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 increased salaries, benefits and data processing costs. Occupancy costs are lower mainly due to the implementation of a new lease accounting standard, IFRS 16. Contracts that meet the definition of a lease under IFRS 16, including many of Coastal's building agreements, are recorded as right-of-use assets and amortized over the expected term.

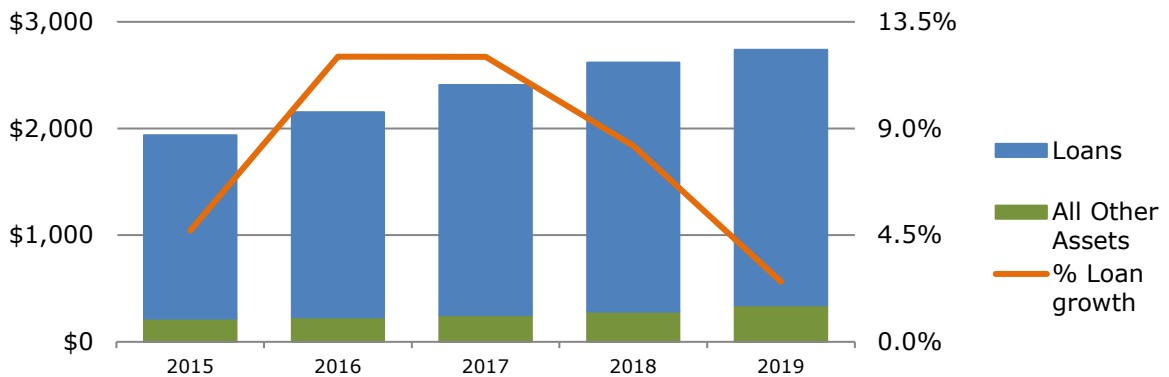
Total operating expenses have declined from a rate of 3.5% of average assets in 2015 to 2.5% in 2019.

### 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 2019 reflects a deterioration in the underlying markets. The cumulative unrealized gain or loss will net to zero when the derivative matures.



### ASSETS (IN MILLIONS)

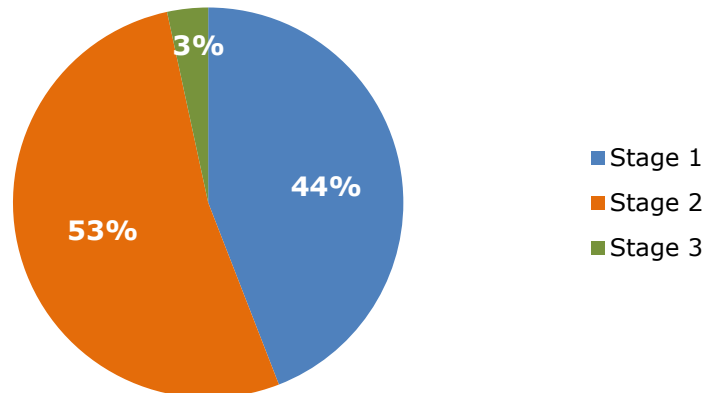


### Loans

Total assets increased from \$2.62 billion to \$2.74 billion or by 4.5%. Member loans make up the largest proportion of total assets. We ended the year with a loan portfolio of \$2,394 million, up \$59 million or 2.5% over 2018. This followed three years of extremely high loan growth. The majority of the growth was in commercial loans. At December 31, 2019, commercial loans totaled \$576 million growing by \$53 million compared to last year. The strong growth reflects robust business confidence. Personal loans ended the year at \$80 million declining \$8 million compared to 2018. Residential mortgage loans grew \$15 million to \$1,738 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).

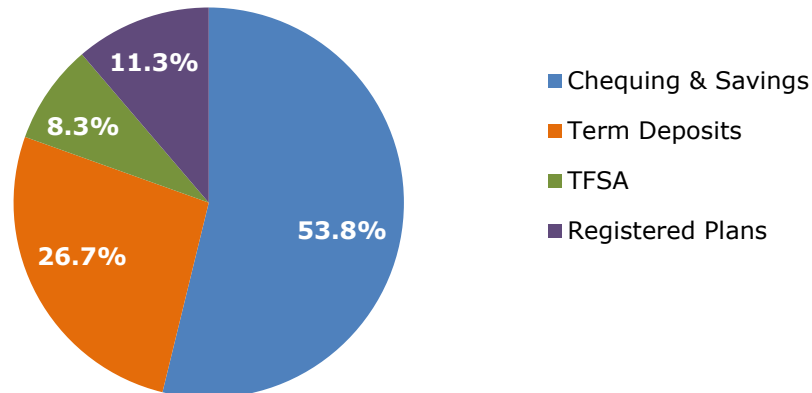
The allowance remained unchanged at \$5.3 million at the end of 2019 although the proportion in each Stage changed slightly.

The total allowance at December 31, 2019 represents 0.22% of total loans which is slightly lower than for 2018.

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 5.0% or \$112 million exceeding \$2,366 million at the end of the year. This followed four years of even higher deposit growth. Chequing and savings accounts hold the largest proportion of member deposits. We were successful in increasing the proportion of tax-free savings accounts (TFSA) 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.

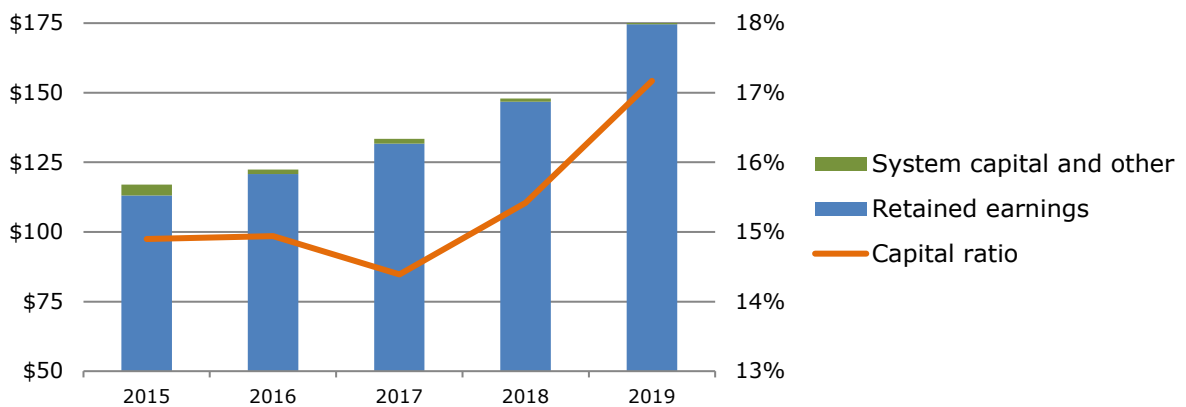
### Borrowings

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 \$27 million to zero as of December 31, 2019.

During the year, Coastal Community participated in the Canada Mortgage Bond program by selling mortgages to third parties in order to fund mortgage growth. At the end of 2019, the carrying amount of secured borrowings increased to \$158 million.



### CAPITAL (IN MILLIONS)



### Retained Earnings and Capital

Retained earnings, which represent the main source of capital for Coastal Community Credit Union, grew by \$27.8 million to \$174.6 million in 2019. 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, 2019 improved from 15.42% to 17.17%.

### 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 22 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.





## 2020 Outlook

Looking ahead to 2020, the Credit Union expects net interest income to compress further due to continued market competition for loans and deposits. Member loan and deposit growth are expected to slow compared to 2019 but remain strong as our branches in the Capital Regional District expand their member base and all market areas experience population migration.

Subsequent to December 31, 2019, the COVID-19 outbreak was declared a pandemic by the World Health Organization. The situation is dynamic with announcements of both monetary and fiscal stimulus packages. The immediate impact to the Credit Union is that interest rate cuts will lower interest income. Other possible impacts could include credit deterioration and a slowdown in loan originations. The Credit Union continues its focus on the financial health and safety of its members and clients during this uncertain 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.