FitchRatings

Banks
Retail & Consumer Banks
New Zealand

Wairarapa Building Society

Key Rating Drivers

Asset Quality Underpins Ratings: Wairarapa Building Society's (WBS) Long-Term Issuer Default Ratings (IDR) and Viability Rating are driven by its good asset quality and satisfactory capitalisation. The resilient asset quality supports the building society's credit profile and reflects its underwriting standards, which are generally consistent with those of peers. A small market share restricts the ratings, as WBS has limited competitive advantage compared with larger domestic peers and is a price-taker in its main operating segments.

Modest Impaired Loan Rise: Fitch Ratings expects the impaired-loan ratio to rise moderately over the next two years in response to the effects of the coronavirus pandemic. However, significant weakening is unlikely. The core metric of impaired loans/gross loans has been resilient, with a four-year average of 1.2%, comfortably within the range for an 'a' factor score.

The 'bb+' factor score for asset quality also takes into account the society's investment-property portfolio, which is susceptible to market value declines during economic downturns. Nonetheless, we believe there is sufficient buffer at the current rating level and have revised the factor outlook to stable, from negative.

Moderate Earnings Deterioration: We expect earnings and profitability to remain pressured over the next two years by low interest rates and subdued credit growth, although any deterioration should be modest. We adjust the earnings and profitability score from that implied by our criteria to 'bb' to account for changes in the value of the society's investment properties, which can lead to higher earnings volatility than peers.

Our expectation of only a modest deterioration in profitability, combined with sufficient buffers at the current rating level, have led us to revise the factor outlook for earnings and profitability to stable, from negative.

Sound Capital Buffers: Capitalisation is a strength for the rating, with the factor score remaining at 'bb+' with a stable outlook. We expect WBS to stay at the top end of its peer group and maintain substantial buffers above regulatory and board minimums over the next two years. The factor score also reflects the small size of WBS's operations and limited ability to generate new capital, which is mainly sourced through retained earnings.

Broadly Steady Funding Profile: We expect WBS to continue using customer deposits as its main funding source and to maintain sound liquidity metrics well above regulatory and board minimums. Buffers at the current factor score of 'bb+' mean we do not expect any downward pressure on this factor over the next two years, although the society's modest franchise, combined with its lack of access to the central bank as a lender of last resort, leave it vulnerable to deposit outflows in a severe funding-market shock.

Rating Sensitivities

Rising Impairments, Increased Risk: The Long-Term IDRs and Viability Rating may be downgraded if asset quality metrics deteriorate significantly beyond Fitch's base case or upon an increase in risk appetite, potentially aimed at expanding market share and profitability, that leads to greater volatility in the financial profile through the cycle.

This may be reflected in a combination of; impaired loans/gross loans increasing consistently above 8%; operating profit/risk-weighted assets repeatedly below 0.5%; or the Fitch core capital ratio declining below 11.5% without a clear plan to replenish capital buffers.

Increased Franchise, Enhanced Governance: An upgrade is not probable in the short term, as it would require WBS to significantly increase its franchise and enhance corporate governance to be in line with that of New Zealand banks, while also strengthening its financial profile.

Ratings

Foreign Currency	
Long-Term IDR	BB+
Short-Term IDR	B
Local Currency	
Long-Term IDR	BB+
Short-Term IDR	B
Viability Rating	bb+
Support Rating	5
Support Rating Floor	NF

Sovereign Risk	
Long-Term Foreign-Currency IDR	AA
Long-Term Local-Currency IDR	AA+
Country Ceiling	AAA

Outlooks	
Long-Term Foreign-Currency IDR	Stable
Long-Term Local-Currency IDR	Stable
Sovereign Long-Term Foreign-Currency IDR	Positive
Sovereign Long-Term Local-Currency IDR	Stable

Applicable Criteria

Bank Rating Criteria (February 2020)

Related Research

Fitch Revises Outlook on Wairarapa Building Society to Stable; Affirms at 'BB+' (March 2021)

Fitch Ratings 2021 Outlook: Asia-Pacific Developed Market Banks (December 2020)

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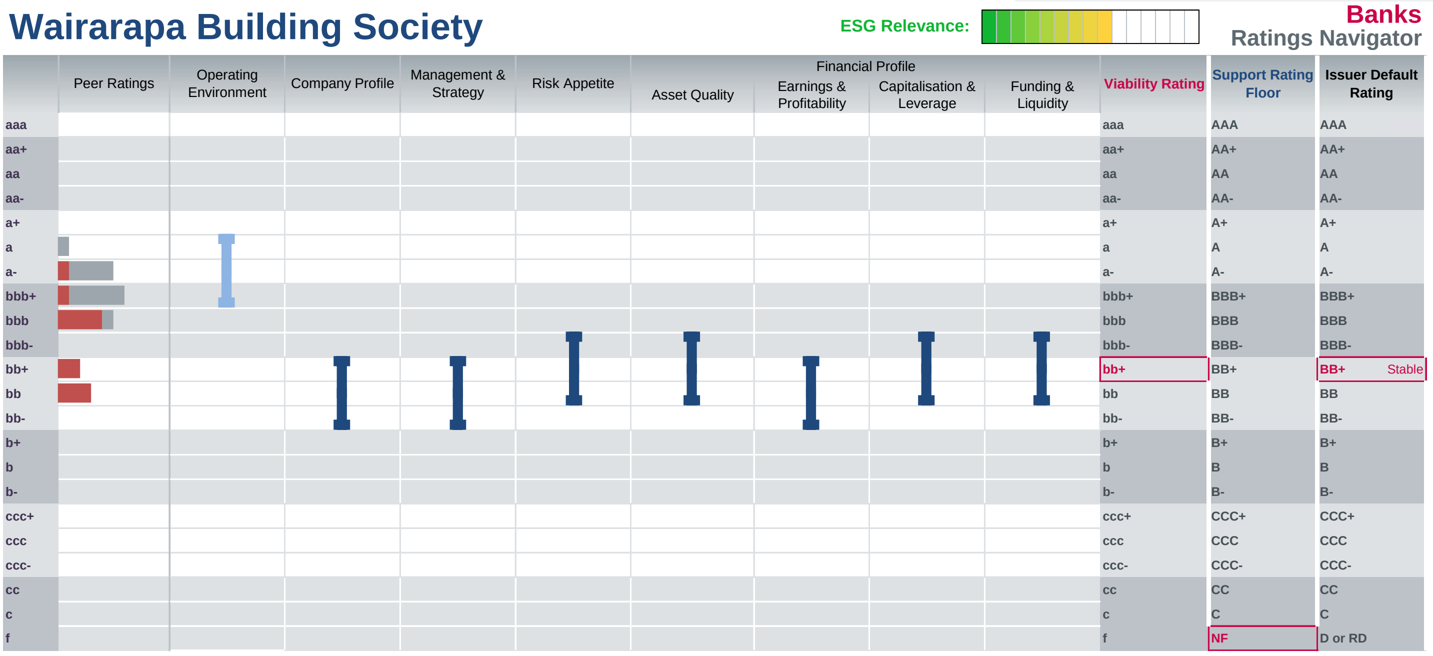
Sovereign/Institutional Support Assessment

Support Rating Floor			Value
Typical D-SIB SRF for sovereign's rating level (assuming high propensity)			A or A-
Actual country D-SIB SRF			N/A
Support Rating Floor:			**NF**
Support Factors	**Positive**	**Neutral**	**Negative**
Sovereign ability to support system			
Size of banking system relative to economy			✓
Size of potential problem		✓	
Structure of banking system			✓
Liability structure of banking system		✓	
Sovereign financial flexibility (for rating level)		✓	
Sovereign propensity to support system			
Resolution legislation with senior debt bail-in			✓
Track record of banking sector support		✓	
Government statements of support			✓
Sovereign propensity to support bank			
Systemic importance			✓
Liability structure of bank	✓		
Ownership		✓	
Specifics of bank failure		✓	
Policy banks			
Policy role			
Funding guarantees and legal status			
Government ownership			

The Support Rating and Support Rating Floor reflect our view that, while support from the New Zealand sovereign is possible, it cannot be relied on. The building society is not part of the open bank resolution scheme, which allows for the imposition of losses on depositors and senior debt holders to recapitalise failed institutions. However, Fitch believes the existence of the scheme, in conjunction with WBS's low systemic importance, means sovereign support is unlikely.

Ratings Navigator



Significant Changes

Operating Environment Outlook Revised to Stable

Fitch has revised the factor outlook on the 'a-' operating environment score assigned to New Zealand non-bank deposit takers (NBDT) to stable from negative. This reflects plans by the authorities to bring the NBDTs under the same regulatory framework as banks; the less stringent framework applied to NBDTs currently is the key reason we maintain a one-notch difference between the operating environment score of the NBDTs and the banks (a/negative). It also takes into consideration New Zealand's success in combatting the coronavirus pandemic, although downside risks remain. We will consider equalising the NBDT operating environment score with the bank score closer to implementation of the new framework.

Asset Quality and Earnings Outlooks Revised to Stable

WBS' performance for both asset quality and profitability have been better than Fitch expected when the factor outlooks were originally revised to negative in May 2020. The impact of the pandemic on asset-quality metrics is yet to be revealed due to government and regulatory support measures still in place. We expect earnings to stay pressured as margin and competitive headwinds hamper profitability. Despite this, we think any deterioration in the core metrics will be modest and not place downward pressure on the factor scores. WBS also has large buffers for each factor at the current scores, which led us to revise both factor outlooks to stable, from negative.

Bar Chart Legend

Vertical bars – VR range of Rating Factor

Bar Colors – Influence on final VR

- Higher influence
- Moderate influence
- Lower influence

Bar Arrows – Rating Factor Outlook

- ⇧ Positive
- ⇩ Negative
- ⇳ Evolving
- ▫ Stable

Brief Company Summary

Operating Environment Risks Manageable

The outlook for the operating environment has improved since early 2020 due to New Zealand's success in handling the health crisis. Fitch expects real GDP to expand by 4.6% in 2021 following a contraction of 2.6% in 2020. However, risks to the outlook remain, with widespread vaccination unlikely to occur until late 2021, meaning international borders are likely to remain largely closed until the end of the year. Outbreaks of the virus in the community may also prompt localised or national lockdowns, while support measures will be gradually unwound during 2021 as well.

Strong house price growth that is fuelled by credit growth poses risk in the medium-term if it leads to a significant increase in household leverage. This would leave households even more susceptible to any sudden increase in interest rates. We already consider New Zealand's high level of household debt when assigning the operating environment score.

Small Franchise with a Simple Business Model

WBS is a small building society operating out of a single branch in Masterton, New Zealand. The entity has a moderate franchise that reflects its concentration in the Wairarapa region and focus on traditional banking products. WBS is smaller than NDBT peers, with a market share of less than 0.1% of New Zealand's bank and non-bank system assets.

WBS has a simple business model and focuses on traditional banking. The society does not offer transactional banking services, such as cheques or ATMs. We view this as a limitation to its business model, as it makes WBS more susceptible to losing clients to competitors. However, this is partly mitigated by the society's strong brand awareness in its home market.

Adequate Management and Board Oversight for Size

WBS's management team is adequate for the company's size. A small staff count means reliance on key individuals is higher than that of larger peers. Corporate governance appears less developed than at higher-rated peers, although is sufficient and does not present a clear or significant risk to WBS's creditors. Strategic objectives are mostly unchanged, despite the economic downturn and disruption caused by the pandemic. WBS is focused on expanding organically and providing members with banking services in a sustainable way. We expect efforts to modernise the bank's systems and digital offering to aid its strategy.

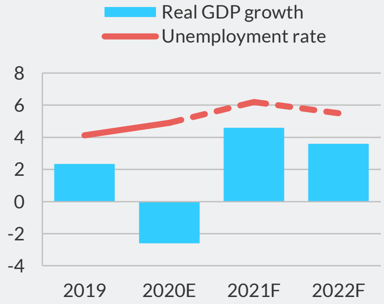
Risk Appetite Consistent with Peers

We believe WBS's risk appetite is generally in line with peers. It operates a traditional banking model, focusing on residential mortgages and commercial loans in the local region. We do not expect any material change in the society's risk appetite in the near term. Underwriting standards are consistent with industry practice. Serviceability for residential mortgages is assessed on an amortising basis, including a material buffer over the offered rate. Personal lending only accounts for a small portion of the loan book; in most instances, consumer loans are only provided to existing customers whom WBS deems as lower risk.

The risk management framework and reporting tools are less sophisticated than that of larger peers, but are acceptable. The society is required to operate within the terms of its trust deed, which outlines restrictions to liquidity, lending, capital and dealings with related parties. Reporting to the trustee is completed monthly. Lending authorities are set at various levels and all exposures in excess of a certain amount are reported to the board on a monthly basis.

Market risk primarily arises from interest-rate mismatch on asset and liabilities on the balance sheet. We believe the society's hedging techniques are basic compared with that of larger domestic banks. WBS employs a natural hedging strategy and matches the interest rate maturity profile of its financial assets and liabilities where possible. WBS also holds an investment property portfolio that adds a degree of market risk. However, historical returns on the portfolio have been generally stable. The property portfolio is revalued every 12 months based on rental income, lease expiry and the current market capitalisation rate.

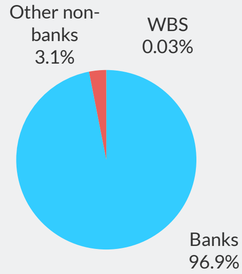
Economic Outlook



Source: Fitch Ratings, Fitch Solutions

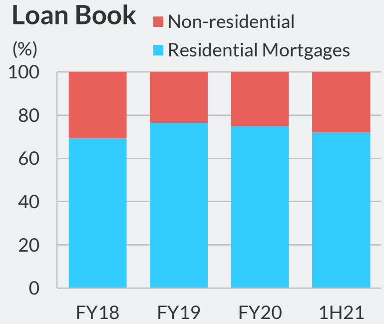
Market Share

Sep 20



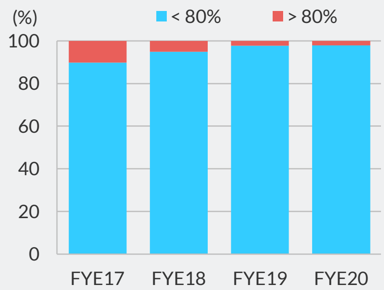
Source: Fitch Ratings, Reserve Bank of New Zealand

Loan Book



Source: Fitch Ratings, WBS

Mortgage Loan/Value Ratios



Source: Fitch Ratings, WBS

Summary Financials and Key Ratios

	30 Sep 20		31 Mar 20	31 Mar 19	31 Mar 18
	6 months - interim	6 months - interim	Year end	Year end	Year end
	(USDm)	(NZD 000)	(NZD 000)	(NZD 000)	(NZD 000)
	Audited – unqualified (emphasis of matter)	Audited – unqualified (emphasis of matter)	Audited - unqualified	Audited - unqualified	Audited - unqualified
Summary income statement					
Net interest and dividend income	1	1,808.0	3,490.0	3,593.0	3,135.0
Net fees and commissions	0.1	86.0	217.0	218.0	107.0
Other operating income	0.3	453.0	1,670.0	1,236.0	530.0
Total operating income	2	2,347.0	5,377.0	5,047.0	3,772.0
Operating costs	1	1,358.0	2,962.0	2,945.0	2,587.0
Pre-impairment operating profit	1	989.0	2,415.0	2,102.0	1,185.0
Loan and other impairment charges	n.a.	n.a.	304.0	-126.0	124.0
Operating profit	1	989.0	2,111.0	2,228.0	1,061.0
Other non-operating items (net)	n.a.	n.a.	20.0	n.a.	14.0
Tax	0	297.0	111.0	477.0	398.0
Net income	0	692.0	2,020.0	1,751.0	677.0
Other comprehensive income	0	8.0	16.0	256.0	16.0
Fitch comprehensive income	0	700.0	2,036.0	2,007.0	693.0
Summary balance sheet					
Assets					
Gross loans	77	116,682.0	127,164.0	126,613.0	132,397.0
- Of which impaired	1	1,875.0	2,627.0	1,611.0	1,012.0
Loan loss allowances	0	620.0	620.0	444.0	350.0
Net loans	77	116,062.0	126,544.0	126,169.0	132,047.0
Interbank	0	20	29,200.0	21,800.0	15,000.0
Derivatives	n.a.	n.a.	n.a.	n.a.	n.a.
Other securities and earning assets	6	8,799.0	8,645.0	7,495.0	8,390.0
Total earning assets	82	124,861.0	164,389.0	155,464.0	155,437.0
Cash and due from banks	26	39,350.0	412.0	239.0	1,813.0
Other assets	2	3,031.0	2,984.0	4,456.0	2,559.0
Total assets	110	167,262.0	167,785.0	160,159.0	159,809.0
Liabilities					
Customer deposits	94	143,095.0	143,782.0	137,537.0	139,272.0
Interbank and other short-term funding	n.a.	n.a.	n.a.	n.a.	n.a.
Other long-term funding	n.a.	n.a.	n.a.	n.a.	n.a.
Trading liabilities and derivatives	0	5.0	34.0	56.0	50.0
Total funding	94	143,100.0	143,816.0	137,593.0	139,322.0
Other liabilities	1	1,612.0	2,119.0	2,672.0	2,438.0
Preference shares and hybrid capital	0	0.0	0.0	0.0	0.0
Total equity	15	22,550.0	21,850.0	19,894.0	18,049.0
Total liabilities and equity	110	167,262.0	167,785.0	160,159.0	159,809.0
Exchange rate		USD1 = NZD1.514463	USD1 = NZD1.6675	USD1 = NZD1.473839	USD1 = NZD1.38831

Source: Fitch Ratings, Fitch Solutions

Summary Financials and Key Ratios

	30 Sep 20	31 Mar 20	31 Mar 19	31 Mar 18
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	1.3	1.4	1.5	0.7
Net interest income/average earning assets	2.2	2.2	2.4	2.1
Non-interest expense/gross revenue	57.9	55.1	58.4	68.6
Net income/average equity	6.2	9.8	9.3	3.8
Asset quality				
Impaired loans ratio	1.6	2.1	1.3	0.8
Growth in gross loans	-8.2	0.4	-4.4	13.5
Loan loss allowances/impaired loans	33.1	23.6	27.6	34.6
Loan impairment charges/average gross loans	n.a.	0.2	-0.1	0.1
Capitalisation				
Common equity Tier 1 ratio	n.a.	n.a.	n.a.	n.a.
Fully loaded common equity Tier 1 ratio	n.a.	n.a.	n.a.	n.a.
Fitch Core Capital ratio	14.7	14.4	13.3	11.8
Tangible common equity/tangible assets	13.5	13.0	12.4	11.3
Basel leverage ratio	n.a.	n.a.	n.a.	n.a.
Net impaired loans/common equity Tier 1	n.a.	n.a.	n.a.	n.a.
Net impaired loans/Fitch Core Capital	5.6	9.2	5.9	3.7
Funding and liquidity				
Loans/customer deposits	81.5	88.4	92.1	95.1
Liquidity coverage ratio	n.a.	n.a.	n.a.	n.a.
Customer deposits/funding	100.0	100.0	100.0	100.0
Net stable funding ratio	n.a.	n.a.	n.a.	n.a.

Source: Fitch Ratings, Fitch Solutions

Key Financial Metrics – Latest Developments

Modest Asset-Quality Deterioration

Fitch expects WBS's impaired loan ratio to increase over the next two years as pandemic-related support measures are unwound. However, we do not expect significant pressure on the building society's factor score due to large buffers at the current rating level. The nation's strong economic recovery from the pandemic mean any deterioration is likely to be modest. Downside risks are notably reduced from when Fitch revised the factor outlook to negative in May 2020.

The assigned factor score is below what the core metric would imply under Fitch's *Bank Rating Criteria* to reflect its non-loan exposures, higher single-name concentration than larger peers, and our expectations around the core metric. Investment properties total around 5% of assets, which means changes in market conditions can cause higher asset-quality volatility through the cycle. Furthermore, geographic concentration in the Wairarapa region and a limited franchise leave WBS more susceptible to asset quality deterioration than larger domestic peers.

Earnings Headwinds Persist, Material Weakening Unlikely

We expect earnings to be hampered by margin pressure, competition and increased impairments over the next two years. However, the deterioration in the core metric of operating profit/risk-weighted assets should be modest due to the strong performance of the broader economy; even under a stressed scenario, we expect profitability metrics to remain consistent with a 'bb' definition.

Non-interest income remains a high portion of operating profit, at 35% in FY20, up from 29% in FY19. A large percentage of this comes from changes in the fair value of the society's investment property portfolio, which recorded a NZD904,000 gain in FY20. Fitch adjusts the factor score for earnings and profitability to reflect higher earning volatility as a result of these price fluctuations. Operating expenses may increase modestly over the medium term as WBS improves its digital offering and modernises its systems; once these upgrades are complete, the society will have room to cut operating costs and improve profitability.

Capital Position Remains Robust

Fitch expects the Fitch core capital and total regulatory capital ratios to improve and remain well above minimum requirements over the next two years. This expectation is reflected in our stable outlook on the 'bb+' factor score. The capital ratios compare favourably with those of some peers. WBS targets to maintain higher capital buffers due to its small size and its ownership structure limiting its ability to raise fresh capital. The society's focus on strong capital buffers remains important, as it protects members from potential losses.

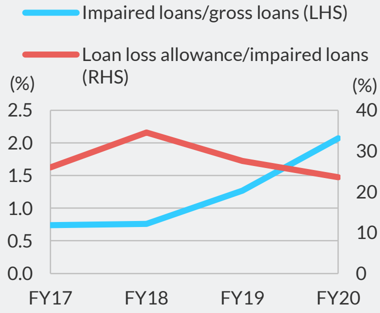
WBS's capital requirements to date have been met by retained earnings. The WBS Charitable Trust, owner of WBS, has limited resources to support WBS's capitalisation, but could provide additional capital through issuance of preference shares. WBS has not yet needed to raise capital this way, but the option does provide additional flexibility.

Stable Funding Profile, Liquidity to Remain Elevated

WBS remains fully deposit funded, and we do not expect any changes to the entity's funding profile over the next two years. System loan growth should remain subdued over the period, while deposit growth is likely to remain strong, reflecting high levels of system liquidity as a result of significant monetary and fiscal stimulus over the last 12 months. WBS does not have direct access to the Reserve Bank of New Zealand's (RBNZ) liquidity facilities, but will benefit from the substantial increase in system deposits as a result of the quantitative easing programme.

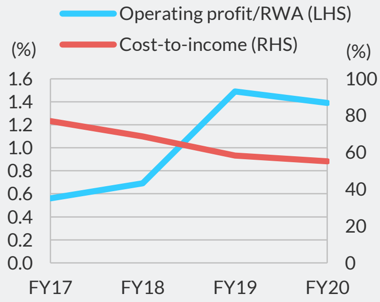
We adjust down the factor score to reflect WBS's limited franchise relative to domestic banks and the lack of access to the lender of last resort facility with the RBNZ, similarly to other domestic NBDTs. WBS's liquidity requirements are guided by its trust deed, which outlines minimum ratios for certain metrics; reported ratios are well above these regulatory minimums. We expect the society's funding profile to remain steady and consistent with peers over the next two years.

Asset Quality



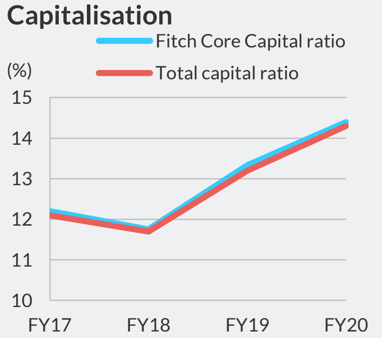
Source: Fitch Ratings, Fitch Solutions, WBS

Profitability



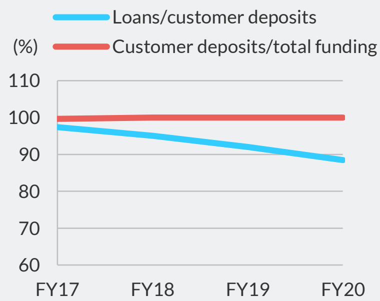
Source: Fitch Ratings, Fitch Solutions, WBS

Capitalisation



Source: Fitch Ratings, Fitch Solutions, WBS

Funding



Source: Fitch Ratings, Fitch Solutions, WBS

Environmental, Social and Governance Considerations

FitchRatings **Wairarapa Building Society**

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

Wairarapa Building Society has 5 ESG potential rating drivers

- Wairarapa Building Society has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.
- Governance is minimally relevant to the rating and is not currently a driver.

			Overall ESG Scale
key driver	0	issues	5
driver	0	issues	4
potential driver	5	issues	3
not a rating driver	4	issues	2
	5	issues	1

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference	E Scale
GHG Emissions & Air Quality	1	n.a.	n.a.	5
Energy Management	1	n.a.	n.a.	4
Water & Wastewater Management	1	n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.	2
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Company Profile; Management & Strategy; Risk Appetite; Asset Quality	1

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference	S Scale
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities: SME and community development programs; financial literacy programs	Company Profile; Management & Strategy; Risk Appetite	5
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Company Profile; Management & Strategy; Risk Appetite	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy	3
Employee Wellbeing	1	n.a.	n.a.	2
Exposure to Social Impacts	2	Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Company Profile; Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Management & Strategy	5
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions	Management & Strategy; Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy	2
				1

How to Read This Page
ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies some of the main ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Principles for Responsible Investing (PRI) and the Sustainability Accounting Standards Board (SASB).

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

CREDIT-RELEVANT ESG SCALE

How relevant are E, S and G issues to the overall credit rating?

5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

Unless otherwise disclosed in this section, the highest level of environmental, social and governance (ESG) credit relevance is a score of 3 - ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.