FitchRatings

Banks
Retail & Consumer Banks
New Zealand

Wairarapa Building Society

Key Rating Drivers

VR Drives Ratings: Wairarapa Building Society's (WBS) Long-Term Issuer Default Ratings (IDRs) are driven by its Viability Rating (VR), which is in line with the implied VR. The VR reflects good asset quality, satisfactory capitalisation and a steady deposit funding base. The resilient asset quality supports WBS's credit profile and reflects the society's underwriting standards. Capital ratios have risen over the last year, providing protection buffers for WBS's members.

Stable Operating Environment: We expect economic conditions in New Zealand to be broadly stable over the next two years, underpinning the stable outlook on our operating environment score of 'a-'. The score is below the 'aa(cat)' score implied by Fitch Ratings' criteria to reflect high household debt in New Zealand.

We also adjust the score to reflect the less stringent regulatory framework for non-bank deposit takers (NBDTs) such as WBS. The framework is moving towards the bank framework, at which point we may equalise the operating environment score with New Zealand's 'a' bank score.

Traditional Banking Focus: WBS's business profile factor score of 'bb-' reflects its stable business model, small franchise and limited competitive advantages. WBS's market share is small at less than 0.1% of total banking and NBDT system assets.

Asset Quality to Improve: We expect WBS's asset quality to improve over the next two years, helped by a domestic economic recovery. The four-year average of WBS's impaired loans/gross loans of 1.2% up to the financial year ended March 2021 (FY21) is within the range for an implied 'a(cat)' factor score. The assigned score of 'bb+' also considers WBS's higher single-name and geographic concentration than larger peers, leaving it more susceptible to negative shocks.

Earnings Above Some Peers: Earnings and profitability metrics have consistently been among the best of the peer group and we expect this will continue over the next two years. The four-year average of the society's operating profit/risk-weighted asset ratio improved to 1.3% in FY21, driving the upgrade of the factor score to 'bb+' from 'bb'. The assigned score is below the implied 'bbb(cat)' score due to less diverse revenue streams than larger peers in New Zealand.

Robust Capitalisation: WBS continues to be well capitalised and Fitch expects its capital ratios to remain towards the top end of its peer group over the next two years. The Fitch Core Capital (FCC) ratio improved to 15.4% by end-September 2021, placing it in the lower half of the 'a(cat)' implied range. Fitch regards these buffers as appropriate given the small absolute size of the capital base, which leaves it more vulnerable to negative shocks than larger peers.

Steady Deposit Funding Base: We expect WBS to remain wholly deposit funded and to maintain sound liquidity metrics well above regulatory minimums. Our upgrade of the factor score to 'bbb-' from 'bb+' reflects sustained improvement in its loan/customer deposit ratio over the last three years. The assigned score is below the 'a(cat)' implied score, reflecting WBS's lack of access to central bank lender of last resort facilities.

Rating Sensitivities

Increased Risk Profile: WBS's Long-Term IDRs and VR may be downgraded if there is an increase in its risk profile, potentially aimed at expanding market share and profitability, that leads to greater volatility in the financial profile through the cycle.

Financial Profile Volatility: A weaker financial profile may manifest in a combination of: impaired loans/gross loans consistently above 8%; operating profit/risk-weighted assets below 0.5% for a sustained period; the FCC ratio below 11.5% without a credible plan to replenish capital buffers; or the loan/customer deposit ratio increasing above 100% on a sustained basis.

Ratings

Foreign Currency	
Long-Term IDR	BB+
Short-Term IDR	B
Local Currency	
Long-Term IDR	BB+
Short-Term IDR	B
Viability Rating	bb+
Government Support Rating	ns
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 (November 2021)

Related Research

Fitch Affirms Wairarapa Building Society at 'BB+'; Outlook Stable (February 2022)

Fitch Ratings 2022 Outlook: Asia-Pacific Developed Market Banks (December 2021)

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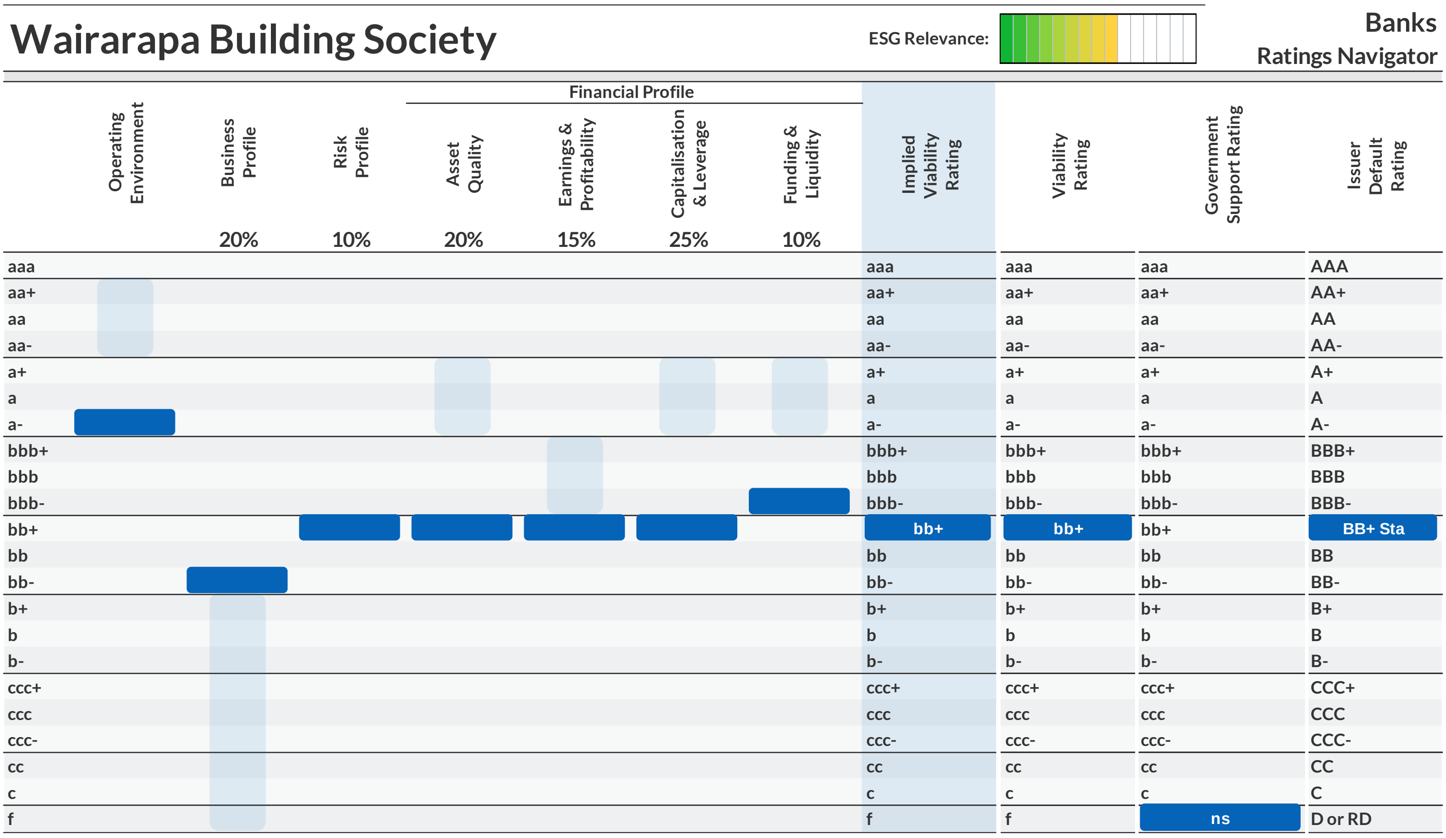
Ratings Navigator



The Key Rating Driver (KRD) weightings used to determine the implied VR are shown as percentages at the top. In cases where the implied VR is adjusted upwards or downwards to arrive at the VR, the KRD associated with the adjustment reason is highlighted in red. The shaded areas indicate the benchmark-implied scores for each KRD.

Brief Company Summary

Solid Outlook for Operating Environment

Our economic forecast for New Zealand has improved significantly since the beginning of the pandemic in 2020. This has been driven by the success of the authorities in dealing with the health crisis, allowing the domestic economy to reopen quickly. Fitch expects real GDP to have expanded by 5.0% in 2021, and forecasts further growth of 3.5% in 2022, although there may be some pressure in the near term as an outbreak of the Omicron Covid-19 variant gathers pace. The unemployment rate has fallen to a record low of 3.4%, which should provide some support to bank asset quality as the effect of the unwinding of pandemic-related support measures works its way through the economy. Inflation has accelerated, prompting an increase in the cash rate of 50bp in 2H21 by the Reserve Bank of New Zealand (RBNZ). We expect a further 75bp increase in 2022.

House price growth accelerated significantly through late 2020 and 2021 and could pose a risk to financial stability in the medium term. As a result, the RBNZ reimplemented macroprudential limits that are tighter than those in place before the pandemic and the government enacted policies aimed at moderating price growth. The RBNZ has also flagged additional measures, including debt/income limits, that could be enforced in 2022. New Zealand's high household leverage relative to that of other countries is factored into our operating environment assessment for NBDTs. Household debt/disposable income was 169% at end-June 2021, a record high.

We also adjust the score to reflect less stringent regulatory oversight of NBDTs relative to banks in our assessment of the operating environment, although the implementation of the Deposit Takers Act from 2023 should result in regulatory oversight transitioning towards levels required for banks. We expect greater clarity on the implementation timetable in 2022.

Simple Business Model with Small Customer Base

WBS is a small building society operating out of a single branch in Masterton, New Zealand. The business model is simple and consistent, reflecting its focus on traditional banking, which offsets the modest franchise. The society does not offer transactional banking services, such as cheques or ATMs, which we regard as a limitation to its business model, as this means it is more susceptible to losing clients to competitors. This risk is partly mitigated by the society's strong brand awareness in its home market and recent improvement in digital capabilities.

WBS's management has adequate depth and experience for the company's size. The previous CEO departed the society in early 2022 and was replaced internally by the former finance manager, an appropriately qualified and experienced candidate. Strategic objectives should remain consistent and will continue to focus on supporting members and providing high quality service. Plans to improve the core banking system and operating efficiencies support these objectives.

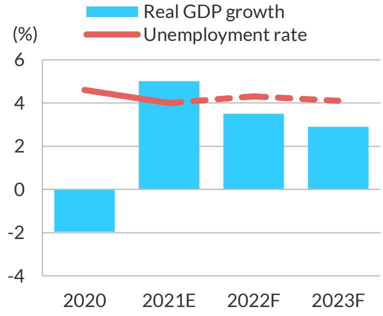
Sound Underwriting Standards

We believe WBS's risk appetite is more conservative than that of some of its NBDT peers, particularly credit unions. We do not expect any material change in the society's risk profile in the near term. Underwriting standards are generally consistent with or better than industry practice. Serviceability for residential mortgages is assessed on an amortising basis, including a material buffer over the offered rate.

The risk management framework and reporting tools are less sophisticated than that of larger peers, but are acceptable. Fitch believes the modernisation of WBS's systems will enable tighter risk controls and better oversight. The society is required to operate within the terms of its trust deed, which outlines restrictions on liquidity, lending, capital and dealings with related parties.

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.

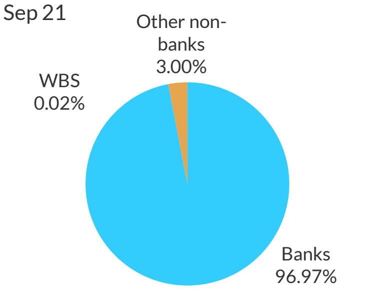
Economic Outlook



Source: Fitch Ratings, Fitch Solutions

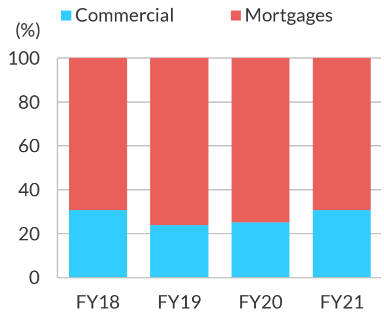
Market Share

Sep 21



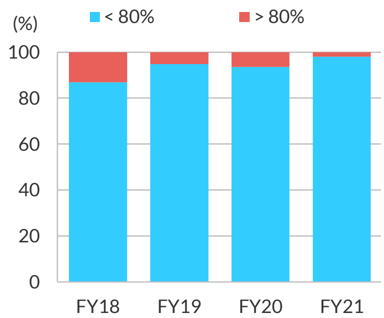
Source: Fitch Ratings, Reserve Bank of New Zealand

Loan Book



Source: Fitch Ratings, WBS

Mortgage Loan/Value Ratios



Source: Fitch Ratings, WBS

Summary Financials and Key Ratios

		30 Sep 2021	31 Mar 2021	31 Mar 2020	31 Mar 2019
	6 Months - Interim	6 Months - Interim	Year End	Year End	Year End
	USDm	NZD000	NZD000	NZD000	NZD000
	Reviewed – Unqualified (Emphasis of Matter)	Reviewed – Unqualified (Emphasis of Matter)	Audited - Unqualified	Audited - Unqualified	Audited - Unqualified
Summary Income Statement					
Net interest and dividend income	2	2,267.0	3,808.0	3,490.0	3,593.0
Net fees and commissions	0	80.0	261.0	217.0	218.0
Other operating income	0	373.0	1,205.0	1,670.0	1,236.0
Total operating income	2	2,720.0	5,274.0	5,377.0	5,047.0
Operating costs	1	1,626.0	2,845.0	2,962.0	2,945.0
Pre-impairment operating profit	1	1,094.0	2,429.0	2,415.0	2,102.0
Loan and other impairment charges	0	35.0	-45.0	304.0	-126.0
Operating profit	1	1,059.0	2,474.0	2,111.0	2,228.0
Other non-operating items (net)	n.a.	n.a.	n.a.	20.0	n.a.
Tax	0	263.0	515.0	111.0	477.0
Net income	1	796.0	1,959.0	2,020.0	1,751.0
Other comprehensive income	0	8.0	-621.0	16.0	256.0
Fitch comprehensive income	1	804.0	1,338.0	2,036.0	2,007.0
Summary Balance Sheet					
Assets					
Gross loans	72	104,197.0	108,046.0	127,164.0	126,613.0
- of which impaired	1	780.0	803.0	2,627.0	1,611.0
Loan loss allowances	0	609.0	575.0	620.0	444.0
Net loans	71	103,588.0	107,471.0	126,544.0	126,169.0
Interbank	25	36,400.0	40,500.0	29,200.0	21,800.0
Derivatives	n.a.	n.a.	n.a.	n.a.	n.a.
Other securities and earning assets	5	6,630.0	6,630.0	8,645.0	7,495.0
Total earning assets	101	146,618.0	154,601.0	164,389.0	155,464.0
Cash and due from banks	0	122.0	1,185.0	412.0	239.0
Other assets	2	2,918.0	2,928.0	2,984.0	4,456.0
Total assets	103	149,658.0	158,714.0	167,785.0	160,159.0
Liabilities					
Customer deposits	86	124,713.0	134,079.0	143,782.0	137,537.0
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	n.a.	n.a.	n.a.	34.0	56.0
Total funding and derivatives	86	124,713.0	134,079.0	143,816.0	137,593.0
Other liabilities	1	953.0	1,447.0	2,119.0	2,672.0
Preference shares and hybrid capital	n.a.	n.a.	n.a.	0.0	0.0
Total equity	16	23,992.0	23,188.0	21,850.0	19,894.0
Total liabilities and equity	103	149,658.0	158,714.0	167,785.0	160,159.0
Exchange rate		USD1 = NZD1.454757	USD1 = NZD1.43082	USD1 = NZD1.6675	USD1 = NZD1.473839

Source: Fitch Ratings, Fitch Solutions, WBS

Summary Financials and Key Ratios

	30 Sep 2021	31 Mar 2021	31 Mar 2020	31 Mar 2019
Ratios (annualised as appropriate, %)				
Profitability				
Operating profit/risk-weighted assets	1.4	1.6	1.4	1.5
Net interest income/average earning assets	3.0	2.4	2.2	2.4
Non-interest expense/gross revenue	59.8	53.9	55.1	58.4
Net income/average equity	6.7	8.7	9.8	9.3
Asset quality				
Impaired loans ratio	0.8	0.7	2.1	1.3
Growth in gross loans	-3.6	-15.0	0.4	-4.4
Loan loss allowances/impaired loans	78.1	71.6	23.6	27.6
Loan impairment charges/average gross loans	0.1	0.0	0.2	-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	15.4	14.0	14.4	13.3
Tangible common equity/tangible assets	15.6	14.2	13.0	12.4
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	0.7	1.0	9.2	5.9
Funding and liquidity				
Gross loans/customer deposits	83.6	80.6	88.4	92.1
Liquidity coverage ratio	n.a.	n.a.	n.a.	n.a.
Customer deposits / total non-equity 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, WBS

Key Financial Metrics – Latest Developments

Impairments to Remain Low

Fitch expects the four-year average of WBS's impaired-loan ratio to improve over the next two years as asset quality metrics return to pre-pandemic levels. WBS has solid buffers at the rating level, meaning the factor score is unlikely to face downward pressure over the next two years. New Zealand's strong economic recovery from the pandemic is likely to support asset quality over this period. Provisions have stayed elevated despite improving asset quality as WBS takes a conservative approach to releasing them.

The assigned factor score is below that implied by the core metric under Fitch's Bank Rating Criteria to reflect WBS's higher single-name and geographical concentrations than larger peers, leaving it more susceptible to asset quality shocks. Also, investment properties total around 4.4% of assets, which means changes in market conditions can cause greater earnings volatility through the cycle as the property values are marked to market.

Improved Earnings Outlook

Fitch expects profitability metrics over the next two years to remain at around similar levels as FY21, which will be notably above those of most other NBDTs, driving our upgrade of the factor score to 'bb+' from 'bb'. We expect the net interest margin to widen to between 2.5% and 3.0% in FY22, reflecting rising interest rates. Fitch expects the four-year average of operating profit/risk-weighted assets to rise moderately in FY22 as weaker performance in earlier years drops out of the calculation. The average places WBS in the middle of the 'bbb(cat)' implied range, although we adjust this lower to the assigned 'bb+' factor score due less revenue diversification than larger peers.

Non-interest income remained at a high 28% of operating income in FY21, although it is lower than the 35% in FY20 due largely to changes in the fair value of the society's investment-property portfolio after it recorded a smaller NZD440,000 gain in FY21, from FY20's NZD904,000 gain. This adds volatility to WBS's earnings. Operating expenses may increase modestly over the medium term as WBS continues to improve its digital offerings and modernise its systems. The new capabilities should improve cost efficiency once completed.

Sound Capital Buffers to Be Maintained

Fitch expects the FCC and total regulatory capital ratios to improve over the next two years and remain well above minimum requirements and towards the top end of its peer group. The society's FCC ratio improved to 15.4% by end-September 2021 due to stable retained earnings and a contraction in the loan book. We believe this ratio will continue to increase, underpinned by the society's profitability. The assigned score of 'bb+' is below the implied 'a(cat)' score to reflect the small absolute size of the capital base, which was just NZD24.0 million (USD17 million) in 1HFY22.

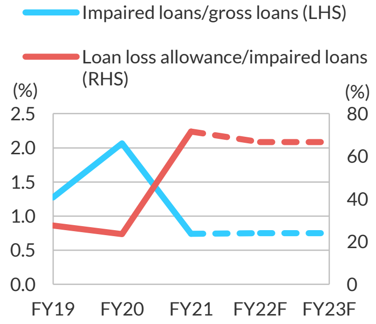
The regulatory total-capital ratio, which is the only regulatory capital metric required to be calculated by WBS, rose by around 120bp in 1HFY22 to 16.9%, well above the 8% regulatory minimum. The larger capital buffers partly reflect the risks associated with WBS's commercial property portfolio to factor in the possibility of a considerable decline in property prices.

Solid Deposit Funding Base

We expect at least part of the improvement in WBS's funding and liquidity profile over the last three years to be maintained, with the loan/customer deposit ratio likely to stabilise between 85% and 90% through FY23. Fitch upgraded the factor score to 'bbb-' from 'bb+' to reflect the improvement. The building society remains fully deposit funded.

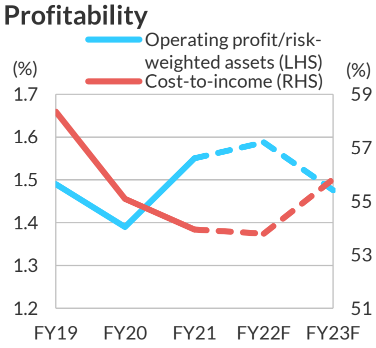
The loan/customer deposit ratio implies an 'a(cat)' score, but we adjust this down to reflect the society's lack of access to the RBNZ's lender of last resort facilities, which could lead to deposit outflows in a funding market shock. WBS's liquidity requirements are guided by its trust deed, which outlines minimum ratios for certain metrics; reported ratios are well above these regulatory minimums.

Asset Quality



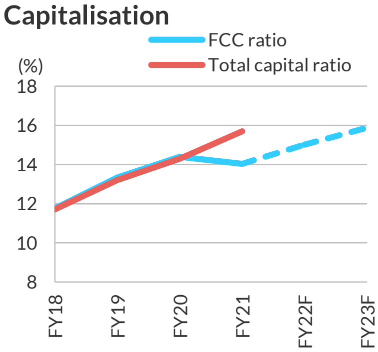
Source: Fitch Ratings, Fitch Solutions, WBS

Profitability



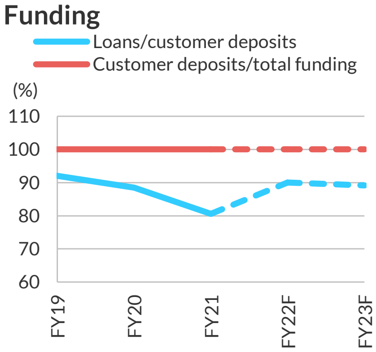
Source: Fitch Ratings, Fitch Solutions, WBS

Capitalisation



Source: Fitch Ratings, Fitch Solutions, WBS

Funding



Source: Fitch Ratings, Fitch Solutions, WBS

Government

Commercial Banks: Government Support Rating KRDs	
Typical D-SIB GSR for sovereign's rating level (assuming high propensity)	A or A-
Actual jurisdiction D-SIB GSR	N/A
Government Support Rating	**ns**
Government ability to support D-SIBs	
Sovereign Rating	AA/ Positive
Size of banking system	Negative
Structure of banking system	Neutral
Sovereign financial flexibility (for rating level)	Neutral
Government propensity to support D-SIBs	
Resolution legislation	Negative
Support stance	Negative
Government propensity to support bank	
Systemic importance	Negative
Liability structure	Positive
Ownership	Neutral

The colours indicate the weighting of each KRD in the assessment.
Higher influence Moderate influence Lower influence

The Government Support Rating of 'ns' assigned to WBS reflects our expectation that there is no reasonable assumption of forthcoming support for the society because of New Zealand's open bank resolution scheme (OBR). WBS is not part of the OBR, which allows for the imposition of losses on depositors and senior debt holders to recapitalise failed institutions. Fitch believes the existence of the scheme, in conjunction with WBS's low systemic importance, makes sovereign support doubtful.

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	Business Profile (incl. Management & governance); Risk Profile; 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	Business Profile (incl. Management & governance); Risk Profile	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; Business Profile (incl. Management & governance); Risk Profile	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Business Profile (incl. Management & governance)	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	Business Profile (incl. Management & governance); Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Business Profile (incl. Management & governance)	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	Business Profile (incl. Management & governance); Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Business Profile (incl. Management & governance)	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Business Profile (incl. Management & governance)	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.