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CREDIT OPINION
16 January 2023

Update

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Auswide Bank Ltd

Update to credit analysis

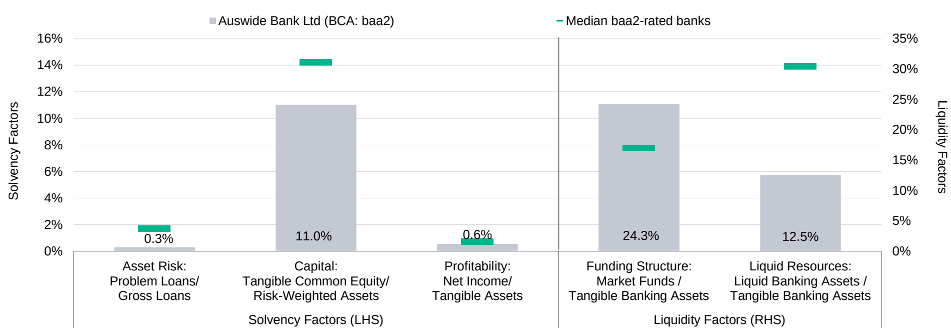
Summary

The Baa2 long-term issuer rating of Auswide Bank Ltd (Auswide) reflects its lending focus on owner-occupier residential mortgages with principal and interest repayments that has supported its very good asset quality. This will also help the bank weather the negative impact of high inflation and rising interest rates, leading to higher but manageable arrears and credit losses.

Earnings, supported by rising interest rates, and capital management capacity will keep the bank's core capital ratio around the current level. We therefore expect the bank to remain soundly capitalized relative to its low risk profile, albeit weaker than peers[1].

The bank's wholesale issuance may rebound to fund credit growth and maturing drawdowns under the Reserve Bank of Australia's (RBA) pandemic-related term funding facility (TFF). Auswide's use of wholesale funding is higher than some peers'. Securitization constituted a third of wholesale funding, reducing asset-liability mismatches and mitigating short-term funding risk.

Exhibit 1
Rating Scorecard - Key financial ratios



Source: Moody's Financial Metrics

RATINGS

Auswide Bank Ltd

Domicile	Australia
Long Term CRR	Baa1
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Not Assigned
Long Term Deposit	Baa2
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the ratings section *at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.*

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Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

Credit strengths

» Focus on conservatively underwritten residential mortgages provides a buffer against asset risks

» Soundly capitalized relative to asset risks

» Ample liquidity to cover unsecured wholesale funding maturities

Credit challenges

» Moderate level of profitability

» Moderate level of wholesale funding (over 20% of total funding)

Outlook

The stable rating outlook reflects our expectation that Auswide will maintain its focus on low-risk home loans over the next 12-18 months

Factors that could lead to an upgrade

» Housing market conditions improve

» The tangible common equity ratio rises above 14.5%

» Market funding/tangible assets ratio falls below 22%, without a rise in the proportion of short-term funding

Factors that could lead to a downgrade

» Asset quality deteriorates significantly, with nonperforming loan ratio rising to 1.5%

» Tangible common equity/risk-weighted assets ratio (TCE ratio) falls below 10.5%

» Liquid asset coverage of unsecured wholesale debt maturities weakens to less than 100%

The calculation basis of Australian bank regulatory capital ratios will be amended in 2023 and we may adjust the bank's TCE ratio rating threshold accordingly.

Key indicators

Exhibit 2
Auswide Bank Ltd (Consolidated Financials) [1]

	06-22[2]	06-21[2]	06-20[2]	06-19[2]	06-18[2]	CAGR/Avg.[3]
Total Assets (AUD Million)	4,504.6	4,155.8	3,788.1	3,603.4	3,349.6	7.7[4]
Total Assets (USD Million)	3,097.6	3,120.0	2,608.1	2,528.7	2,474.9	5.8[4]
Tangible Common Equity (AUD Million)	215.3	204.1	190.9	186.1	184.1	4.0[4]
Tangible Common Equity (USD Million)	148.1	153.2	131.5	130.6	136.0	2.1[4]
Problem Loans / Gross Loans (%)	0.2	0.3	0.4	0.4	0.3	0.3[5]
Tangible Common Equity / Risk Weighted Assets (%)	11.0	11.4	11.7	12.4	13.4	12.0[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	2.7	4.9	6.8	6.9	5.0	5.2[5]
Net Interest Margin (%)	1.9	2.0	1.9	1.9	1.9	1.9[5]
PPI / Average RWA (%)	2.0	2.1	1.9	1.8	1.9	1.9[6]
Net Income / Tangible Assets (%)	0.6	0.6	0.5	0.5	0.5	0.5[5]
Cost / Income Ratio (%)	54.1	53.3	56.0	58.8	58.2	56.1[5]
Market Funds / Tangible Banking Assets (%)	24.3	22.0	23.3	25.9	28.7	24.8[5]
Liquid Banking Assets / Tangible Banking Assets (%)	12.5	11.8	11.8	11.1	10.7	11.6[5]
Gross Loans / Due to Customers (%)	125.3	121.4	122.6	130.2	138.6	127.6[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; IFRS. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.
Sources: Moody's Investors Service and company filings

Profile

Auswide Bank Ltd (Auswide) is a small listed bank in Australia and reported AUD3.9 billions total loans as of 30 June 2022, with 98% of these loans being residential mortgages. It is geographically concentrated in the state of Queensland, with 70% of total loans from this state and supplemented by New South Wales (15% of total loans) and Victoria (11%). Within Queensland, its lending is now largely to Southeast Queensland (40% of total loans as of June 2022), exceeding that of Central Queensland, traditionally its core market, which accounted for about 30% of total loans.

Detailed credit considerations

Focus on conservatively underwritten residential mortgage lending provides a buffer against asset risks

Pandemic-related risks receded in 2022 amid a strong economic recovery and the bank's nonperforming loans dropped to below its pre-pandemic level of 0.2%, but the outlook for asset risk in 2023 is more challenging because of high inflation and rising interest rates placing pressure on borrowers' repayment ability and house prices.

However, lending conservatism will help the bank weather these risks. Auswide's uptake of first-time home buyers and conservative risk appetite have increased its share of owner-occupier loans to 74% of total mortgages as of June 2022 from 67% three years ago, and share of loans with principal and interest repayment to 87% from 79%. The bank will continue this business setting as it pursues credit growth at 1.5x to 2x system average and will rely on pricing strategy and broadening distribution channels for credit growth.

Weaker credit demand from first-time home buyers will help contain the share of loans with high loan-to-value ratios (that is, LVR higher than 80%) which was 35% as of June 2022 and higher than peers, and regulatory expectations will contain the share of loans with high debt-to-income ratios (that is, DTI higher than 6x), which ramped up during the last three years.

Auswide has also applied a serviceability buffer when assessing loan applications. The minimum buffer was 2.5 percentage points over the actual loan rates prior to October 2021, when the buffer increased to three percentage points, indicating the extent to which borrowers should be able to withstand interest rate increases.

The bank's private banking, which services high-net-worth individuals, has grown to 9% of total loans over three years to June 2022 and expected to expand further. Most of its customers are from essential services, with medical professionals comprising nearly half of this segment, and the underlying products are conservatively underwritten residential mortgages.

Nevertheless, the bank's higher-than-peer concentration in Queensland exposes it to climate risks, although it has not incurred large credit losses in recent years.

These considerations, on balance, underpin our downward adjustment to the Asset Risk and Business Diversification sections of our scorecard.

Soundly capitalized relative to asset risks

Credit growth and normalization of dividend payouts have weakened Auswide's tangible common equity ratio by 140 basis points to 10.63% over three years to 30 June 2022. We expect the bank to remain around this level, with better earnings outlook and capital raising capacity balancing its targeted credit growth. We therefore expect the bank will remain soundly capitalized relative to its risk profile, albeit lower than peers.

Bottom line limited by cost base and focus on low-risk mortgage lending

Rising interest rates will offer the potential to widen the margin between loan rates and deposit rates after the bank maintained its net interest margin around 2% in the last three years, a level better than many peers. Nevertheless, the upside will be limited by competition for quality loans in a slower housing market and a pickup in funding costs.

At the same time, loan provisioning has come down from the precautionary high at the peak of the pandemic, with an AUD0.6 million impairment expenses in fiscal 2021 and AUD3.8 million in fiscal 2020 shifting to an impairment benefit of AUD0.7 million for fiscal 2022, but may creep up again because of inflationary pressures.

In addition, the bank's ongoing investment in digital transformation, branch network and overheads to support business growth will weigh on operating expenses, and make the bank reliant on earnings to improve cost-to-income from 61% as of June 2022.

Overall, we expect the bank's ratio of net income/tangible asset to improve modestly in 2023, but remain lower than that of larger Australian banks that benefit from economies of scale and a diversified product offering.

Moderate level of wholesale funding and strong liquidity

Wholesale issuance may rebound to fund credit growth and maturing drawdowns under the TFF (4% of total funding as of June 2022) in 2023-24 given an easing in the systemwide household saving ratio from its pandemic highs. The bank's credit growth has well exceeded its retail deposit growth over 2022.

Any increase in wholesale funding will be gradual, considering the bank's ongoing efforts to attract retail funding, including pricing strategy and investment into its branch network across Queensland from which the bank sources large proportion of deposits, deposit partnerships and online deposit channels.

At 27% as of June 2022, the share of wholesale funding was moderately higher than peers', although a third of these was composed of securitization as of June 2022, reducing the mismatch between assets and liabilities and mitigating short-term funding risks. The remainder is largely negotiable certificates of deposit (NCDs, 30% of wholesale funding) and supplemented by floating rate notes (18%).

The bank's liquid assets, at 12.5% of tangible assets as of June 2022, substantially cover unsecured wholesale funding. Additional liquidity from the Reserve Bank of Australia (RBA) in case of a crisis can come from self-originated mortgage-backed securities[2], underpinning our upward adjustment to the Liquid Resources section of the scorecard.

Auswide's rating is supported by Australia's Strong+ operating environment

Australia's Strong+ Macro Profile reflects the country's very high degree of economic resilience, institutional and government financial strength and low susceptibility to event risk. Our baseline scenario projects a recovery in real GDP growth to 3.2% in 2022 and 1.9% in 2023, following 4.7% in 2021 and negative 2.2% in 2020.

A significant pick-up in inflation because of ongoing supply chain issues, rising global commodity prices and domestic supply factors has dampened economic sentiment, following the strong rebound in economic activity when pandemic restrictions were withdrawn. Tightening monetary policy is expected to counter surging inflation and moderate economic growth, with the former expected to peak in 2023. Labor markets remain tight with unemployment falling to 3.5% as of September 2022. Commodity prices are expected to moderate from their pandemic highs but remain favorable compared with historical averages, continuing to benefit several key export industries. House prices have begun contracting from their peak in April 2022, after growing 16.7% in the previous 12 months, and household debt/annualized disposable income continued to rise to 187.5% as of June 2022. Rising interest rates could reduce prepayment buffers built by residential mortgage borrowers or put some borrowers under financial pressure. However, low unemployment and low loan to value ratios on home loans and small business loans which are typically secured by residential properties, should provide buffers to asset quality risk.

Australian banks' pricing power has historically been supported by the high level of concentration in the banking sector. NIMs are starting to recover as the RBA official cash rate rises from its record low reached during the pandemic. The RBA has increased the cash rate target by 300 basis points since April 2022, with potential for further rate hikes in 2023. The rise in interest rates is positive for banks' NIMs because the increasing spread between loan yields and deposit costs will support margin expansion. However, the cost of new market funding is on the rise, constraining some of this spread benefit. The benefit of higher interest rates will be more evident in fiscal 2023 and 2024-25 as fixed rate residential mortgages are refinanced at higher rates.

Australia's structural reliance on external financing remains a key vulnerability. Australian banks have been extending the term structure of their wholesale market funding for a number of years and pre-fund upcoming maturities well in advance. We expect high levels of wholesale debt funding in 2023 as banks look to refund their drawdowns under the TFF, prior to final maturities in 2024, and as deposit growth slows from its high pace during the pandemic. In its pandemic response, the RBA also increased its bond purchases and term repo operations, boosting system-level liquidity. This substantial increase in high quality liquid assets has reduced the banking system's reliance on the RBA's committed liquidity facility, which will be phased out and withdrawn by 1 January 2023.

ESG considerations

Auswide Bank Ltd's ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 3
ESG Credit Impact Score

CIS-2
Neutral-to-Low

NEGATIVE IMPACT POSITIVE IMPACT

For an issuer scored CIS-2 (Neutral-to-Low), its ESG attributes are overall considered as having a neutral-to-low impact on the current rating; i.e., the overall influence of these attributes on the rating is non-material.

Source: Moody's Investors Service

Auswide Bank Ltd's ESG Credit Impact Score is neutral-to-low (**CIS-2**) reflecting the limited credit impact of environmental and social risk factors on the ratings to date and low governance risks.

Exhibit 4
ESG Issuer Profile Scores

ENVIRONMENTAL	SOCIAL	GOVERNANCE
E-2	**S-4**	**G-2**
Neutral-to-Low	Highly Negative	Neutral-to-Low

Source: Moody's Investors Service

Environmental
Auswide Bank Ltd faces neutral-to-low environmental risks. The bank's lower-than-industry-average environmental risk is driven by its limited exposure to carbon transition risks because its loan book is concentrated in Australian residential mortgages, with very low exposures to commercial and unsecured loans. It has a large loan exposure to Queensland, which faces natural disasters captured under physical climate risk such as cyclones and floods that could damage homes, but this risk is largely mitigated by insurance cover and a track record of government assistance.

Social
Auswide Bank Ltd faces high industrywide social risks from customer relations (regulatory risk, litigation exposure and high compliance standards). The bank also faces industrywide moderate social risks related to societal trends, particularly digitalization, and the extent to which such measures could hurt earnings and subject it to data security and customer privacy breaches. Ongoing investment in technology will support the bank in meeting rising digital expectations from customers.

Governance
Auswide Bank Ltd faces low governance risks. The bank's risk management policies and procedures are commensurate with its risk appetite, evident by its track record of strong asset quality and balance sheet strength. Auswide has a relatively simple organizational structure reflecting its domestic and retail-oriented franchise.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Support and structural considerations

Loss Given Failure (LGF) analysis

There is currently no statutory bail-in framework in Australia. As a result, we do not consider Australia to have an operational resolution regime (as defined in our Banks Methodology). We apply a basic LGF approach in rating Australian banks' junior securities. To determine whether Australia has an operational resolution regime, we take both the current resolution framework and Australian policymakers' public stance into account. Although Australia is a member of the Financial Stability Board, which has highlighted the lack of statutory bail-in as a gap compared with international standards, the authorities have so far adopted a more nuanced public stance on this issue.

In contrast to loss absorbing capacity requirements in many other jurisdictions, the APRA has not proposed a new form of loss absorbing instrument or a statutory bail-in framework. There are also no proposed legislative changes to impose explicit burden sharing on bank creditors. However, APRA indicated in 2020 that it will work on a new prudential standard on resolution and recovery planning.

On 2 December 2021, the APRA released its final loss absorbing capacity requirements for domestic systemically important banks (D-SIBs). This follows APRA's release, on 29 November, of its final capital framework. The new rules raise the minimum CET1 ratio requirement to 10.25% from 8% for D-SIBs, 9.25% from 7% for banks authorized to use their internal models to calculate RWA and 8% from 7% for banks that use standardized RWA. APRA has chosen to raise the CET1 requirement by increasing the capital conservation buffer and setting the countercyclical capital buffer at 1%, which was previously set at 0%.

APRA's final loss absorbing capacity requirements will add 4.5 percentage points to the minimum total capital requirements for D-SIBs, a 1.5 percentage point increase from the 3 percentage point interim requirement announced in 2019. This new requirement is likely to be met with Tier 2 capital.

Counterparty Risk (CR) Assessment

Auswide's CR Assessment is positioned at Baa1(cr)/P-2(cr)

Auswide's long-term CR Assessment is positioned one notch above its Adjusted Baseline Credit Assessment (BCA) and consequently above the Preliminary Rating Assessment of senior unsecured debt obligations. This reflects our view that the probability of default on obligations that the CR Assessment represents is lower than that for senior unsecured debt. We believe that senior obligations that the CR Assessment represents are more likely to be preserved to limit contagion, minimize losses and avoid disruption to critical functions.

Auswide's CR Assessment does not benefit from government support, in line with our support assumptions for senior unsecured debt. This reflects our view that the operating activities and obligations that the CR Assessment reflects are unlikely to benefit from support provisions from resolution authorities to senior unsecured debt.

Counterparty Risk Ratings (CRRs)

Auswide's CRRs are positioned at Baa1/P-2

Auswide's long-term CRR is positioned one notch above its Adjusted BCA and does not benefit from government support, in line with our support assumptions on senior unsecured debt.

Methodology and scorecard

About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating methodology and scorecard factors

Exhibit 5
Auswide Bank Ltd

Macro Factors		
Weighted Macro Profile	**Strong +**	**100%**

Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	0.3%	aa1	↔	a2	Quality of assets	Geographical concentration
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	11.0%	baa1	↔	baa1	Access to capital	Risk-weighted capitalisation
Profitability						
Net Income / Tangible Assets	0.6%	baa2	↔	baa3	Expected trend	
Combined Solvency Score		a2		baa1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	24.3%	baa1	↔	baa1	Expected trend	Extent of market funding reliance
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	12.5%	ba1	↔	baa2	Additional liquidity resources	
Combined Liquidity Score		baa2		baa1		
Financial Profile				baa1		
Qualitative Adjustments				Adjustment		
Business Diversification				-1		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				-1		
Sovereign or Affiliate constraint				Aaa		
BCA Scorecard-indicated Outcome - Range				baa1 - baa3		
Assigned BCA				baa2		
Affiliate Support notching				0		
Adjusted BCA				baa2		

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	1	0	baa1	0	Baa1	Baa1
Counterparty Risk Assessment	1	0	baa1 (cr)	0	Baa1(cr)	
Deposits	0	0	baa2	0	Baa2	Baa2
Senior unsecured bank debt	0	0	baa2	0	Baa2	Baa2

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Investors Service

Ratings

Exhibit 6

Category	Moody's Rating
AUSWIDE BANK LTD	
Outlook	Stable
Counterparty Risk Rating	Baa1/P-2
Bank Deposits	Baa2/P-2
Baseline Credit Assessment	baa2
Adjusted Baseline Credit Assessment	baa2
Counterparty Risk Assessment	Baa1(cr)/P-2(cr)
Issuer Rating	Baa2
ST Issuer Rating	P-2

Source: Moody's Investors Service

Endnotes

1 Small Australian banks focusing on residential mortgage lending. Many of those banks are mutually owned deposit-taking financial institutions (ADIs).

2 The RBA allows Australian banks this facility to address the country's low level of sovereign debt and the modest scale of its bond market, which limits the availability of traditional liquid assets, such as government bonds, for banks' liquidity management needs.

REPORT NUMBER 1350308

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