CREDIT OPINION

19 June 2024

Update

Send Your Feedback

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.

Contacts

Daniel Yu, CFA +61.2.9270.8198
VP-Sr Credit Officer
daniel.yu@moodys.com

Patrick Winsbury +61.2.9270.8183
Associate Managing Director
patrick.winsbury@moodys.com

Auswide Bank Ltd

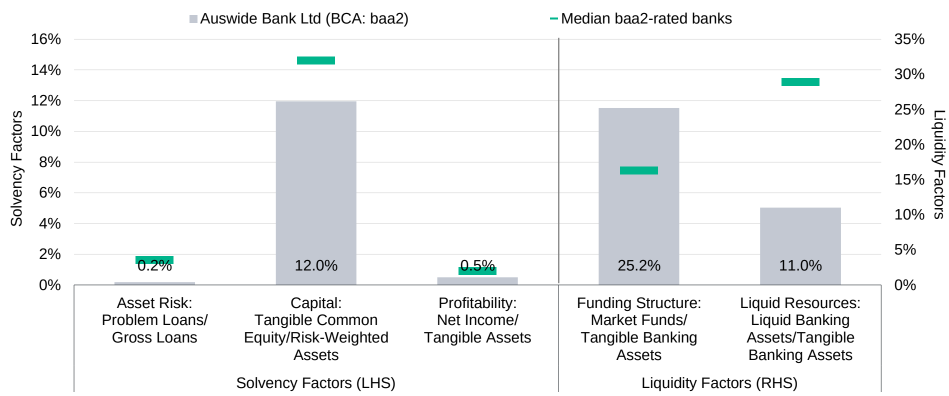
Update following rating affirmation

Summary

Auswide Bank Ltd's Baa2 long-term issuer rating of reflects the bank's strong asset quality which is underpinned by its focus on residential mortgages. And whilst high interest rates and inflation are likely to drive up loan delinquencies, we expect this risk to be manageable in the context of the bank's conservative underwriting. Competitive pressures for both lending and deposits, and ongoing technology investments are key challenges for profitability, although we expect the bank's organic capital generation to remain sufficient to support its current capital levels. Although the bank's funding profile is largely dependent on retail deposits, its moderate reliance on market funding creates a sensitivity to potential market volatility, particularly given the bank's relatively small size.

Exhibit 1

Rating Scorecard - Key financial ratios



Source: Moody's Ratings

Credit strengths

» A focus on conservatively underwritten residential mortgage loans provides a buffer against asset risks

» Sound capitalization

» Rating is supported by Australia's strong operating environment

Credit challenges

» Intense competition will constrain profitability

» Reliance on market funds for about 25% of funding creates a sensitivity to market conditions

Outlook

The rating outlook is stable.

Factors that could lead to an upgrade

The ratings could be upgraded if the bank is able to sustain a tangible common equity (TCE)/risk-weighted assets ratio above 14.5% through the cycle while and reduce its market funding/tangible assets ratio below 22%, without a material reduction in the duration of this funding.

Factors that could lead to a downgrade

The rating could face downward pressure if the bank's problem loans/gross loans rised above 1.5%, the TCE ratio declines below 10.5%, its market funds ratio exceeds 30% or liquid assets are insufficient to cover its unsecured wholesale debt maturities.

Key indicators

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

	06-23[2]	06-22[2]	06-21[2]	06-20[2]	06-19[2]	CAGR/Avg.[3]
Total Assets (AUD Million)	5,059.5	4,504.6	4,155.8	3,788.1	3,603.4	8.9[4]
Total Assets (USD Million)	3,367.9	3,097.6	3,120.0	2,608.1	2,528.7	7.4[4]
Tangible Common Equity (AUD Million)	233.2	215.3	204.1	190.9	186.1	5.8[4]
Tangible Common Equity (USD Million)	155.2	148.1	153.2	131.5	130.6	4.4[4]
Problem Loans / Gross Loans (%)	0.1	0.2	0.3	0.4	0.4	0.3[5]
Tangible Common Equity / Risk Weighted Assets (%)	12.0	11.0	11.4	11.7	12.4	11.7[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	2.1	2.7	4.9	6.8	6.9	4.7[5]
Net Interest Margin (%)	1.9	1.9	2.0	1.9	1.9	1.9[5]
PPI / Average RWA (%)	1.8	2.0	2.1	1.9	1.8	1.9[6]
Net Income / Tangible Assets (%)	0.5	0.6	0.6	0.5	0.5	0.5[5]
Cost / Income Ratio (%)	58.0	54.1	53.3	56.0	58.8	56.1[5]
Market Funds / Tangible Banking Assets (%)	25.2	24.3	22.0	23.3	25.9	24.1[5]
Liquid Banking Assets / Tangible Banking Assets (%)	11.0	12.2	11.4	11.1	10.7	11.3[5]
Gross Loans / Due to Customers (%)	128.4	125.3	121.4	122.6	130.2	125.6[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 Ratings and company filings

Profile

Auswide Bank Ltd is a listed bank in Australia with total loans of AUD4.4 billion as of 30 June 2023. The bank is essentially a residential mortgage lender, which account for 97% of gross loans. The bank's focus is within the state of Queensland, which accounted for approximately 65% of total loans. More than half of these loans in Queensland originated from the Southeast region of the state, with the rest primarily divided between New South Wales and Victoria.

Detailed credit considerations

Conservatively underwriting provides a buffer against asset risks

Despite the bank's very strong asset quality performance - its problem loan ratio has been well below 0.5% for the last five years - we expect some weakening in this metric give the pressures of high inflation and high interest rates. Futhermore, a portion of fixed-rate borrowers, originated prior to the recent surge in the cash rate, are still on extremely low interest rates and will face a repayment shock when their loans reprice.

However, we expect any rise in problem loans to be moderated by the country's robust employment conditions which, despite the anticipated gradual increase in the unemployment rate, are likely to remain healthy. Mortgage borrowers have also managed to accumulate loan prepayment buffers during the years of ultra-low interest rates.

Moreover, the bank has demonstrated lending prudence, even during periods of significant credit growth. For example, and similarly to other Australian banks, Auswide applies, at origination, a 3% interest-rate serviceability buffer above the current rate to assess a borrower's repayment capacity. As of September 2023, 90% of the bank's mortgages were principal and interest loans, with owner-occupied mortgages comprising 76%. High loan-to-value ratio (LVR > 80%) mortgages dropped from 35% to 25% at June 2023, reflecting reduced demand from first-time homebuyers, who are typically younger and have limited savings or equity buffers.

The bank maintains a private banking segment, which services high-net-worth individuals and makes up 10% of total loans at June 2023, with further growth anticipated. Most of these customers are from the essential services sectors, with medical professionals constituting almost 40%. Similar to the bank's broader business, the private bank division is focussed on residential mortgages and incorporates the same conservative underwriting.

A substantial portion of the bank's lending is concentrated within its home state of Queensland which, at times, has been exposed to significant weather events. However, this vulnerability has not led to significant credit losses to date. Furthermore, the bank is currently pursuing expansion beyond its home state.

These considerations are reflected in the Business Diversification and Asset Risk sections of the bank's scorecard.

Intense competition to constrain profit growth

In fiscal 2023, Auswide's net interest margin (NIM) held steady at around 1.9%, reflecting the benefit of interest-rate increases but also the challenges from competition and rising funding costs as depositors transitioned to higher-yielding term deposits.

After growing its loan book strongly for a number of years, we expect a greater focus on margin preservation over the next 12 months, which could come at the expense of some loan growth. The bank's NIM will also be supported by repricing the large volume of maturing fixed-rate loans, though competition may temper these gains.

We expect system loan growth to taper as economic growth slows. This revenue headwind highlights the need for banks to increasingly focus on expense management, which will be challenging given the need for ongoing investment in digital capabilities. Nonetheless, the bank has demonstrated an ability to manage its Cost-To-Income (CTI) ratio effectively, which has been hovering around 60%.

Overall, we expect the bank's net income/tangible assets ratio to remain sound and around its current level of 0.5%.

Sound capitalization provides a buffer against potential credit losses

During FY2023, Auswide's TCE ratio improved to 12% from 11% in the prior year. Driving the improvement was a change in the regulatory capital framework, implemented in January 2023, which provided a 90 basis points benefit to the capital ratio by reducing risk-weighted assets. We expect the bank will maintain this level of capital in the coming years, providing a sound buffer against potential credit losses.

Moderate level of wholesale funding but ample liquidity

Auswide has maintained a market funds/tangible banking assets ratio within a 20%-25% range, highlighting a moderate reliance on market funds. We expect this level of market funds to remain steady, given the bank's demonstrated ability to match credit growth with deposit growth. Unlike other much larger banks, Auswide's refinancing burden from the 2024 maturities of drawdowns from the pandemic-related Term Funding Facility is a small, accounting for about 2% of total funding as of June 2023.

Although Auswide has a slightly higher proportion of market funds than its peers, the bank also benefits from a greater diversity of funding sources. For example, as of June 2023, half the bank's wholesale funding was from securitization which enhances the duration of its funding. The reminder of the wholesale funding is made up of negotiable certificates of deposit (NCDs, a third of wholesale funding) and floating-rate notes (18%).

Retail deposits are mainly from households with most of them comprising small-denomination accounts which are insured by the Financial Claims Scheme (FCS), supporting their stability. A large portion of deposits are at-call deposits, which included mortgage-linked offset accounts, transaction accounts, and savings accounts.

The baa2 score in our scorecard reflects our evaluation of the diversity and stability of the bank's funding.

As of June 2023, the bank's liquid assets, constituting 11% of its tangible assets, almost matched its unsecured wholesale funding and fully covered outstanding short-term NCDs at that time. Additional liquidity can come from self-originated mortgage-backed securities[1], underpinning our upward adjustment to the Liquid Resources section of the scorecard. These securities should be at least 10% of the bank's liabilities, with the capacity to increase to 20% within a one-month time frame.

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

Australia's Strong+ Macro Profile reflects the country's robust economic strength, institutions and governance strength, and low susceptibility to event risk. Our stance remains unchanged despite our baseline scenario suggests real GDP growth of 1.5% in 2023 and 1.3% in 2024, as higher interest rates constrain growth, before improving to 2% in 2025. Alongside this, we foresee a small uptick in the unemployment rate, rising from a very low level of less than 4% to 4.5% in 2025. High levels of household debt remain a key economic vulnerability. As an indicator, household debt relative to income were high at 186.7% as of June 2023. High interest rates add to households' debt burden and reduce repayment buffers built by borrowers.

Despite this, the projected unemployment rate is considered strong by historical measures, and the banks focus on low LVRs on home loans and small business loans, which are typically secured by residential properties, should provide buffers against asset-quality risk. National average house prices underwent a 9.1% drop from April 2022 to February 2023, but they have rebounded from the February trough.

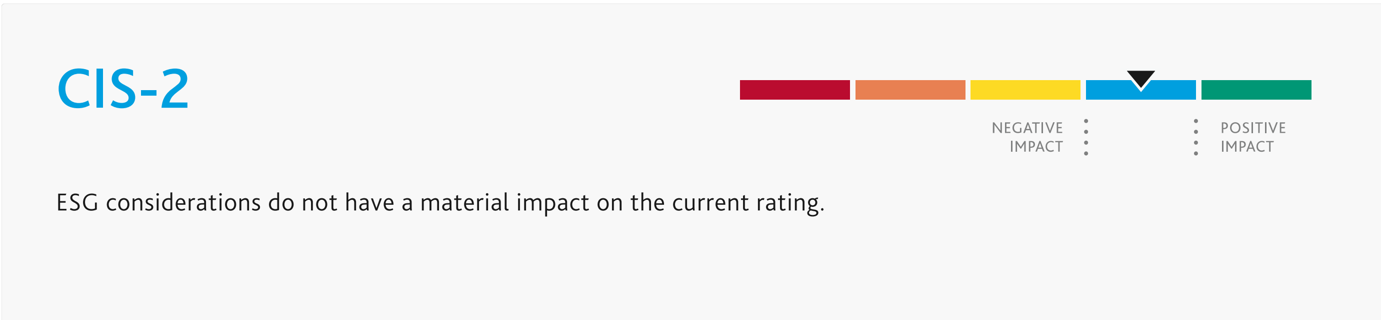
Australian banks' very strong pricing power has historically been supported by the high level of concentration in the banking sector. Higher interest rate has also helped to improve bank net interest margins. However, banks continue to repay the cheap funding provided by RBA and compete for retail deposits, and they accommodate customer preference for term deposits over at-call deposits. These factors could constrain further net interest margin gains from 2024 onwards.

Australia's structural reliance on external financing remains a key vulnerability. However, Australian banks have been extending the term structure of their wholesale market funding for a number of years and are pre-funding upcoming maturities well in advance.

ESG considerations

Auswide Bank Ltd's ESG credit impact score is CIS-2

Exhibit 3
ESG credit impact score



Source: Moody's Ratings

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

Source: Moody's Ratings

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

We apply our Basic LGF analysis to Australian banks that we expect to be initially excluded from the regulator's resolution planning requirements outlined in Prudential Standard CPS 900, and which do not have total loss-absorbing capital requirements.

Under this approach, the Preliminary Rating (PR) Assessment represents our view of the expected loss of a debt class without government support. The PR Assessments of long-term deposits and senior unsecured debt for the bank are aligned with its Adjusted BCA. The PR Assessments of Counterparty Risk (CR) Assessment and Counterparty Risk Rating (CRR) are one notch above the Adjusted BCA. This positioning reflects our view that the probability of default on obligations represented by the CR Assessment and CRR is lower than that of senior unsecured debt because obligations represented by the CR Assessment and CRR are more likely to be preserved to limit contagion, minimize losses and avoid the disruption of critical functions.

Counterparty Risk (CR) Assessment

Auswide's CRAs are (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.

Government support considerations

We do not incorporate government support into the ratings for Auswide, based on our assessment of the bank's systemic importance.

Counterparty Risk Ratings (CRRs)

Auswide's CRRs Baa1/P-2

For banks in non-ORR countries, the CRR is positioned in line with the CRA, one notch above the bank's Adjusted BCA.

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	0.2%	aa1	↔	a2	Quality of assets	Expected trend
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	12.0%	baa1	↔	baa1	Access to capital	Risk-weighted capitalisation
Profitability						
Net Income / Tangible Assets	0.5%	baa2	↔	baa2		
Combined Solvency Score		a2		a3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	25.2%	baa2	↔	baa2	Extent of market funding reliance	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	11.0%	ba1	↔	baa2	Additional liquidity resources	
Combined Liquidity Score		baa3		baa2		
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 Ratings

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 Ratings

Endnotes

1 The Reserve Bank of Australia (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 1409891

CLIENT SERVICES

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