COMPANY CREDIT REPORT

New Zealand-Based First Credit Union Assigned 'BB' Long-Term Counterparty Credit Rating; Outlook Stable

Counterparty Credit Rating

BB/Stable/B

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RatingsDirect
Publication Date
Sept. 8, 2009

Overview

- First Credit Union has a good franchise in the Hamilton and Tauranga regions of New Zealand and a well-established and supportive member base.
- Standard & Poor's has assigned its 'BB' long-term counterparty credit rating to FCU. The outlook is stable.

Rating Action

On Sept. 9, 2009, Standard & Poor's assigned its 'BB' long-term counterparty credit rating to First Credit Union (FCU). The short-term rating on FCU is 'B'. The outlook is stable.

Rationale

The counterparty credit ratings on First Credit Union (FCU) reflect its good franchise in the Hamilton and Tauranga regions of New Zealand and its well-established and supportive member base. Importantly, this business position has underpinned FCU's ability to generate good interest margins to contend with a recent increase in delinquent loans—and to contend with recent liquidity- and funding-based credit-market pressures. These strengths are moderated by FCU's credit-risk profile, which is heightened by its exposure to lower socioeconomic customers in its personal-loan portfolio and its property-development mortgage exposures. Additionally, FCU's credit profile suffers from its limited financial flexibility as a mutual company. Less important but still noteworthy is the key person risk stemming from a heavy reliance on its two most senior executives, and the limited skill set of its community-based board.

While small in the context of the New Zealand financial services sector, FCU has a good and sustainable market position as a member- and community-focused financial institution positioning itself as a supplementary banker to its membership base and offering a limited number of lending- and savings-based products and services. FCU's ability to generate business is underpinned by the depositor support it has maintained with its membership base and its ability to be flexible with its underwriting framework relative to its competitors (other credit unions, trading banks, and finance companies). FCU's high lending rates have enabled it to absorb higher loan-loss provisioning charges and have helped it manage its depositor reinvestment rates and its liquidity position through the attractive pricing of its deposit products. Although FCU's interest margin was compressed through most of 2008 and 2009 as a result of a strong focus on maintaining liquidity through pricing, the progressive roll-off of higher cost deposits is expected to positively impact margins this year.

FCU's asset quality improved in the second half of fiscal 2009 as a result of write-offs and resolutions of some delinquent loans. Its credit-risk profile is also expected to improve with the reduction of its property-development exposures and its single-customer concentrations, and after recent conservative provisioning.

FCU's funding profile is concentrated, with activities funded by member deposits and a deposit base reliant on a number of large depositors. The absolute size of FCU's capital base is moderate by domestic and international standards, although capital adequacy is viewed as sound relative to the credit union's risk profile, growth needs, and its ability to comply with the regulatory capital adequacy framework expected to be introduced in 2010. Constituted as a mutual, FCU has limited financial flexibility to raise capital to contend with a major stress event.

Short-term credit factors

The short-term rating on FCU is 'B'. FCU's balance-sheet liquidity is sound, underpinned by its large holding of cash and liquid assets, which accounted for about 25% of its balance sheet and largely comprised of deposits with two highly-rated trading banks and the New Zealand Association of Credit Unions (NZACU), and spread across at-call one-, two-, and three-month fixed deposits. Term deposits with the trading banks can be redeemed within two days. FCU's liquidity position is also supported by its ability to institute a "Sixty Day Clause" under its trust deed where members would be required to give 60 days notice to withdraw funds deposited with FCU.

FCU has a good history of depositor support from its member base and liquidity was assisted by the system stability brought about through the depositor guarantee from New Zealand's government.

Outlook

The stable ratings outlook recognizes an expectation that FCU's business and financial profiles will remain sound during New Zealand's current economic downturn, and through regulatory changes affecting the credit union sector such as the move to a new regulatory capital framework and changes to the government's depositor-guarantee scheme. Importantly, the outlook factors in our expectation that FCU will soon reduce its property-development-type lending exposures. The outlook also reflects our expectation that FCU's financial profile will improve in the current fiscal year as a result of increased earnings stemming from interest-margin improvement and lower loan provisioning.

FCU's ratings could come under downward pressure if asset quality, which has shown signs of improvement in the past six months, were to rise materially again, or if there were a material moderation of the credit union's earnings or capital adequacy position. Additionally, amalgamation with other credit unions—where the combined financial profile was materially weakened or where the risk profile was materially increased—could have downward ratings consequences.

FCU's upward ratings prospects are limited in the short-to-medium term and would require a step change in key elements of its credit profile. These might include a material increase in its absolute capital base and a track record of managing the company's capital adequacy ratio well above any regulatory minimum, the effective implementation of a more-robust risk-management framework, and some further geographic diversification—including elimination of single-customer concentrations within the loan portfolio relative to the capital base.

Ratings List

New Rating; CreditWatch/Outlook Action

First Credit Union	
Counterparty Credit Rating	BB/Stable/B

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