Sunshine Coast
CREDIT UNION
*Together, we enrich lives.*

# MANAGEMENT DISCUSSION AND ANALYSIS

SUNSHINE COAST CREDIT UNION
**2017** ANNUAL REPORT

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# Management Discussion and Analysis

## Introduction

This Management Discussion and Analysis report provides a general overview of the credit union's performance and is intended to be read with the 2017 Annual Report and full financial statements. Please review both here: www.sunshineccu.com/Report.

2017 was another excellent financial year for Sunshine Coast Credit Union (SCCU). A strong real estate market combined with the support of our members, employees and Board of Directors, empowered the organization to exceed the majority of our internal growth and performance targets. This financial success is essential to building a strong and stable credit union, one that is positioned to provide the scope of expertise, products and services our members expect from us today, and well into the future.

## Assets, Loans and Deposits

SCCU has seen robust asset growth over the last four years. In 2017, assets surpassed the $600 million mark, ending the year at $640 million, representing growth of 13.65%. Over the past three years, asset growth has increased over 32%, much of which can be attributed to a very strong local real estate market and our members choosing the credit union for their lending and investment needs. In addition, wealth management assets under administration grew by a notable $27 million, or 21.5% in 2017.

Lending over the past three years has been exceptional due to market conditions, contributing to SCCU's record growth in this area. An active real estate market and increasing property values, coupled with strong commercial lending opportunities resulted in total loan growth of $73.5 million or 14.82% this past year.

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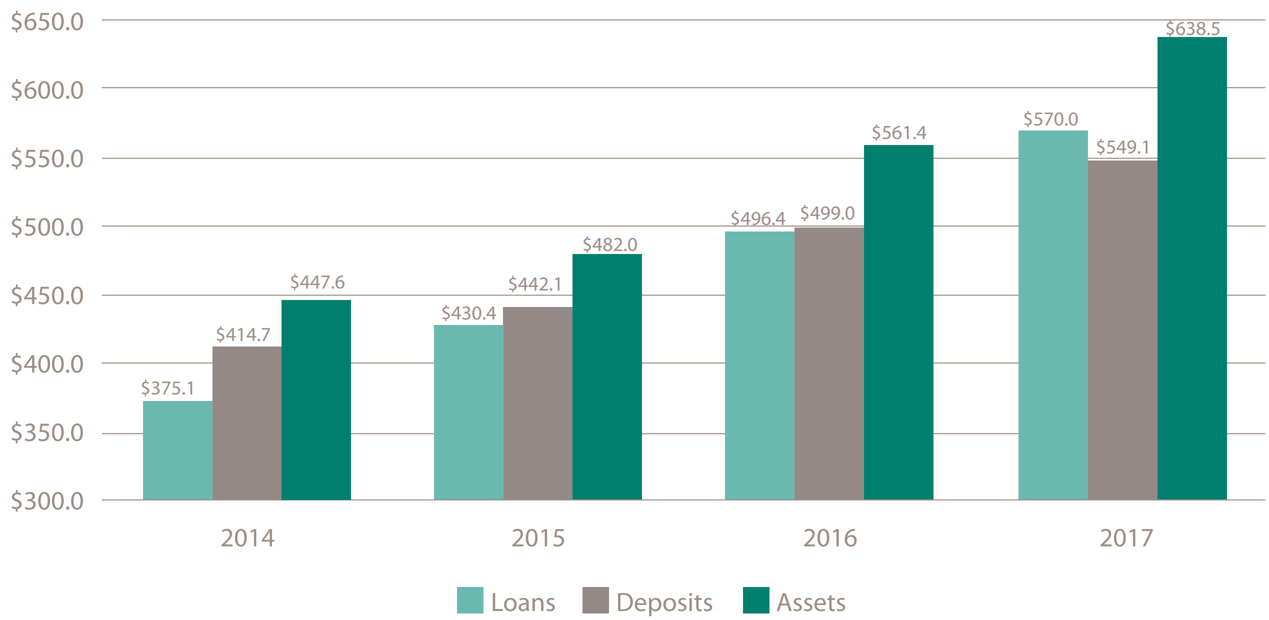
To continue to meet our members' lending needs, SCCU relies heavily on our members' investments with us to fund those lending requests. While deposit growth was strong at $50 million or 10.02%, it did not match the lending growth in 2017.

Secured borrowing is a standard industry tool available to financial institutions to address this type of mismatch. As such, SCCU entered into secured borrowings in 2017 of an additional $21 million (for a total of $44.7 million) to meet our members' lending expectations.

SCCU's liquidity ratio was 9.85% at the end of 2017, slightly lower than December 31, 2016's ratio of 10.66%. While the statutory minimum for liquidity is 8.00%, SCCU targets a healthy ratio of between 10.00% and 12.00%.



## Retained Earnings, Capital, Capital Adequacy

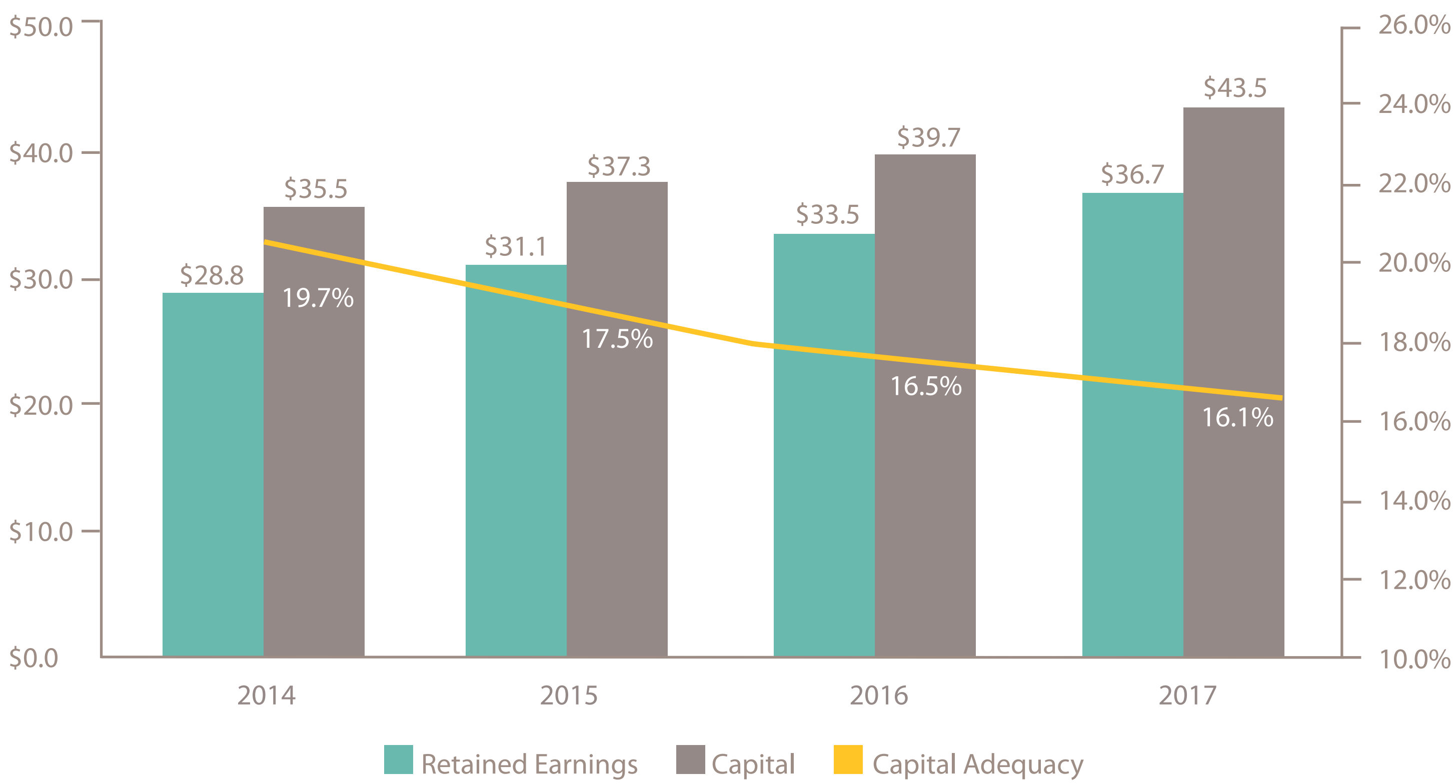
The combination of exceptional achievements in growth and a widening of interest rate spreads in 2017 resulted in an operating margin of $16.2 million compared to $14.2 million in 2016. As outlined below, operating expenses also increased, but to a lesser degree, ending the year at $12.4 million compared to $11.2 million in 2016. SCCU continues to ensure expenses are managed appropriately and efficiencies are sought both internally and through our collaboration with others. All of this resulted in net earnings of $3.3 million.

SCCU's total comprehensive income of $2.3 million includes losses that have not actually occurred; these are referred to as *unrealized losses*. Including *unrealized losses* is an accounting treatment that requires entities reporting under International Financial Reporting Standards to apply a fair value to certain balance sheet transactions. *Fair value* is defined as an amount that an existing asset could be exchanged or traded for at current prices.

It is important to note that these gains/losses have not actually occurred but are included in the reporting to demonstrate that if SCCU actually cancels the product or transaction, these losses/gains would become realized and subsequently amortized through profit and loss over the remaining term of the agreement.

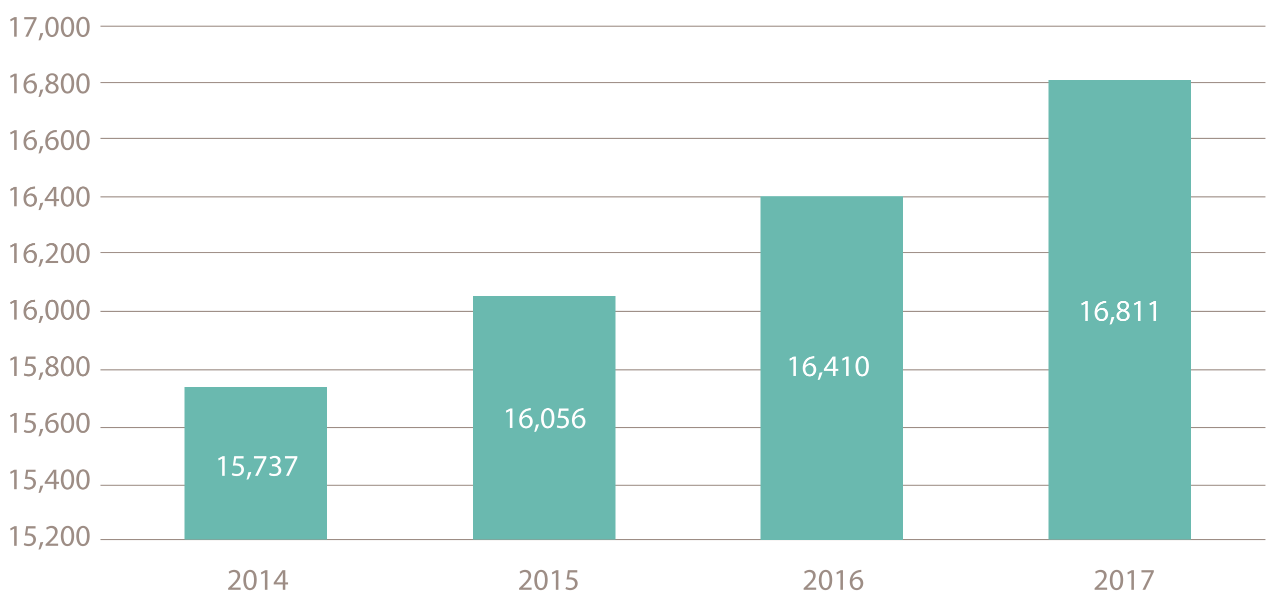
The unrealized loss on hedges found under other comprehensive income on SCCU's Statement of Earnings and Comprehensive Income is the result of the credit union entering into hedging transactions to reduce interest rate risk (fluctuations) and to ensure earnings remain steady and stable. At this time, the hedging transactions SCCU has entered into have been and continue to be highly effective in reducing interest rate risk. As such, SCCU has no plans to cancel these hedges prior to maturity and, when held to maturity, would never realize any fair value gain or loss.

With other comprehensive income being an unrealized accounting transaction only, SCCU transferred the full $3.3 million in net earnings to retained earnings. Total capital, the majority of which includes retained earnings, shares, and a portion of system retained earnings, grew to $43.5 million from $39.7 million in 2016. These returns support a strong, stable capital position and resulted in a much slower decline in the capital adequacy ratio than we have seen in previous years. In 2017 capital adequacy fell by 0.40%, coming in at a healthy 16.1%, which is well above the statutory requirement of 8%.



## Membership

Membership growth has remained strong and stable over the last four years, with an increase in net membership growth occurring each year. In 2017 we achieved just over 400 net new memberships (2.46% growth), which surpassed our target goal of 369 (2.25%).

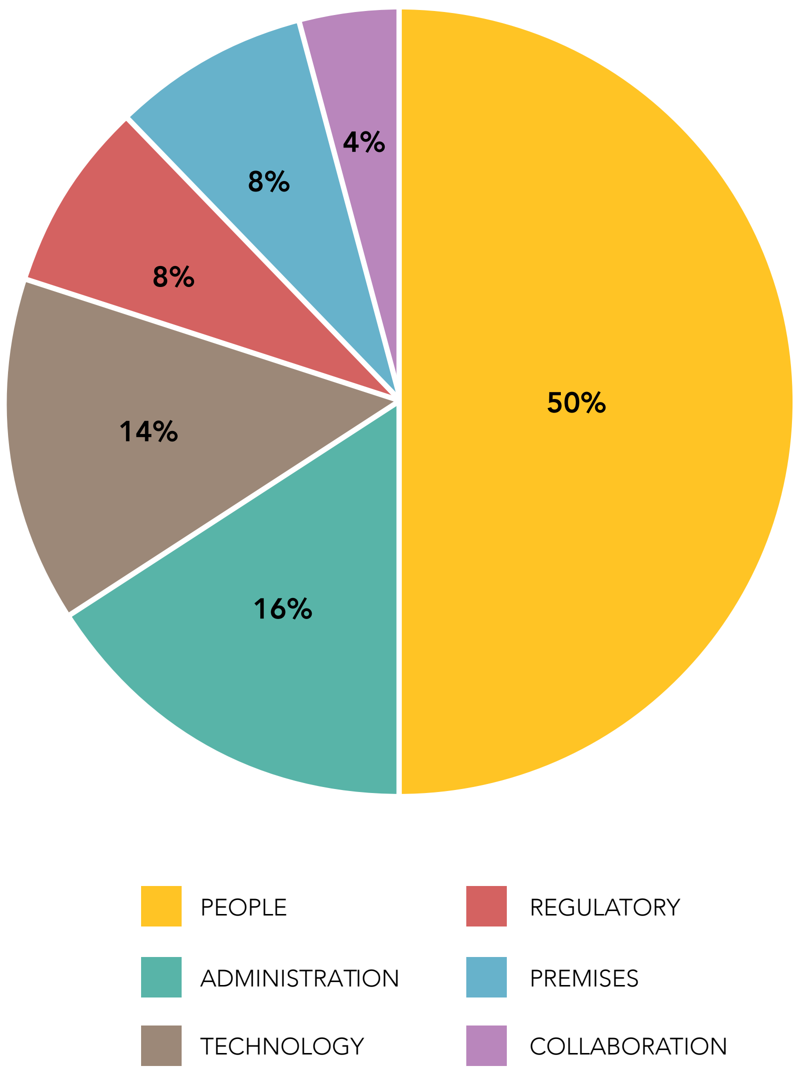



## Profit Allocations

SCCU distributed $114.5 thousand or 3% of net operating income to community enrichment in 2017. In addition, the Board of Directors approved a dividend return of 2% on member and transactional equity shares, and 4% on voluntary investment equity shares, which resulted in distributing over $100 thousand in dividends to our members. For information related to the calculation of dividends, please refer to the Credit Union's Rules.

## Operating Expenses

SCCU's financial success is invested right back into building an experience for our members that meets their needs today, but that also anticipates future expectations. Our operating expenses totaled $12.4 million in 2017, and our related activities can be categorized as an investment in people, administration, technology, regulatory requirements, premises and collaboration.



## People

Our members' financial health is built on the trusted expertise and advice provided by our employees. In support of this, we are attracting top talent through competitive salaries and benefits, continuing to invest in employee learning and development, and integrating expertise across the organization that is completely focused on enhancing the member experience.

## Administration

Administrative expenses are general costs related to effectively operating the credit union, including office equipment, supplies, insurance, legal, marketing and consulting fees.

## Technology

Technology is changing at an unprecedented rate, and it is SCCU's commitment to adapt to these changes that will enable us to deliver on the expectations of our multi-generational members. Our technology investments include annual maintenance fees to operate our banking system and connect to payment networks, as well as launching new initiatives. In 2017 we invested in advancing our digital strategy through our national credit union collaboration.

## Regulatory

Keeping your credit union safe and sound is a constant priority. Regulatory requirements have increased substantially over the years, requiring significantly more of our resources dedicated to consulting and oversight, ensuring we remain compliant with legislation. These include the Financial Institutions Act, Credit Union Incorporation Act, Anti-Money Laundering, Foreign Account Tax Compliant Act and Canadian Anti-Spam-Legislation. Annual audits are also conducted, including those related to information technology governance, retail and commercial lending as well as anti-money laundering.

## Premises

We are pleased to provide members with more than a digital presence. We maintain branches in three of the Sunshine Coast's communities so that our members can choose personal face to face service with our advisors. In 2017 we also opened the doors to our new Member Service Centre (MSC), giving members the convenience of receiving personal and immediate service during business hours through phone, email or Live *Chat*.

## Collaboration

Our collaboration within our industry spans twenty credit unions across the country and more than fourteen initiatives. These initiatives relate to technology, wealth management and risk management, empowering us to achieve the scale and scope required to be competitive in the dynamic financial services industry, and to bring enhanced value to our members.

## Risks & Contingency

Sunshine Coast Credit Union is committed to safeguarding our members' assets. The financial services industry is highly regulated, and SCCU has policies, processes and regular audits in place to ensure compliance. In addition, the credit union has proactively implemented a best-in-class risk management framework to aid management in its operational decisions, as well as regularly informing the Board of Directors. Built in collaboration with other credit unions, this framework allows the credit union to monitor and mitigate current and emerging risks relevant to all financial institutions.

## Future Performance

As a locally-owned and operated co-operative, our success measures go beyond financial metrics. Our Strategic Goals span multiple areas we believe are critical to our sustainability, and our continued ability to provide exceptional value to more than 16,800 members. These include goals related to the Member & Employee Experience, Growth, our Community and Financial targets. SCCU's activities are focused on being the Sunshine Coast's best community partner, fostering strong employee engagement, and delivering transformative service to our members. All of these goals fuel our financial success. Our long term future performance forecast is based on growth of greater than 8%, maintaining capital at more than 12%, an operating income of more than 80 basis percentage points, operating efficiency in the top system quartile and a 20% return on investment from our subsidiaries and partnerships.