Why Toronto-Dominion Bank Doesn't Need to Worry About Falling House Prices

Description

For years now, analysts have been claiming that Canadian housing is overvalued, and that a correction – or worse – is imminent. Thus far, they have been wrong, and house prices have continued to climb. Unfortunately, that makes house prices look even more inflated.

This has consistently been a prime topic of conversation among investors in the Canadian banks. Specifically, investors are wondering what effect a housing correction would have on their bottom lines.

On that note, below we take a look at one of the country's biggest banks, **Toronto-Dominion Bank** (TSX: TD)(NYSE: TD). When we look at the evidence, we find the bank is well-positioned in this environment. Below are three reasons why this is the case.

1. Mortgages are very safe

When faced with declining house prices, investors naturally worry about a bank's mortgage loans. After all, mortgages – especially the subprime variety – are what sunk so many American banks during the financial crisis.

But in Canada, the story is very different. Most mortgages are insured by the CMHC, meaning that banks face no credit risk on these loans. And as of last year, about three quarters of TD's mortgages were insured by the CMHC.

With uninsured mortgages, TD on average lends out 70% of a home's value. In other words, if an average borrower defaults, then his house would have to decline by 30% before TD loses any money.

It's no wonder that last year TD lost only $16 million from residential mortgages, despite holding over $175 billion in mortgages throughout the year. Even if this $16 million number doubles next year, no shareholder will notice.

2. Rising interest rates: a good thing!

As it stands, interest rates remain very low in Canada, and this is a main reason why house prices are so high. But that begs the question: when interest rates rise, will that spell trouble for Canada's indebted population? And what effect will that have on the banks?

Well, actually the banks are hoping interest rates will rise. The reason is quite simple – when banks lend out money, they are not earning very much interest income. When interest rates rise, these banks will be able to charge more for their loans.

And in any case, interest rates are likely to remain low for quite some time.

3. The right exposure

The newest worry seems to be that lower oil prices will lead to a housing correction. After all, Canada's economy is very dependent on energy.

But where TD is concentrated, oil's slide is actually good news. In Canada, nearly half of loans are in Ontario, which benefits from lower gas prices and a lower Canadian dollar. Down in the United States, a lower gas price means more money in the pockets of TD customers.

So TD's customers have little to worry about oil's slide. And this means they should have no trouble paying back their TD loans.

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