



## Is Kevin O'Leary Right About Canadian Housing?

### Description

Kevin O'Leary has never been shy about sharing his opinion.

When O'Leary was on the CBC realty show *Dragon's Den*, he was infamous as the mean Dragon. He would mock terrible ideas, reducing the pitchers to tears on more than one occasion when he thought their business wasn't worth his time.

These days O'Leary is still on the American version of *Dragon's Den*, called *Shark Tank*. He's also a commentator for *Business News Network* (BNN), appearing on a sporadic basis. He offers his views on the market, investments, and government policy.

During a recent appearance on BNN, the subject got to Canadian housing. O'Leary said he's not an investor in the space because cap rates just aren't high enough today to get him excited. But at the same time, he thinks the folks calling for a 30% or 50% correction are way too aggressive in their dire predictions. O'Leary sees a period of flat or slightly declining prices.

O'Leary specifically said, "I'm completely against purchasing a house because I don't think five years from now it'll be worth a dime more than it is today, and yet you've got to pay real estate taxes; if you buy you've got to pay transfer taxes on the land, you have to pay the brokers 3-5% ... It's going to cost you between 8 and 12% to trade the asset.

"The chance that you're going to get 12% appreciation in a home over the next five years is zero. So you'd be an idiot to buy a house. You'd be way better off to rent and keep that capital."

O'Leary isn't alone. There are dozens of other pundits who are bearish on Canadian real estate, all of which give the same advice to potential home owners. They point at things like a high price-to-income ratio, and the fact it's cheaper to rent than buy in most Canadian markets. It's good to be in a spot where a landlord subsidizes your living expenses, especially when you won't be exposed to what these pundits think is an inevitable downturn.

Many folks reading this aren't too worried about a real estate correction. They've got their principal residence and that's it, with most in no hurry to sell their home. But what about Canada's bank stocks?

### Is it time to avoid the banks?

Canada's banks seems quite reasonably valued on the surface. They trade at between 10-13 times earnings, while the rest of the market has a multiple in the 15-17 range.

There's a reason for that. Investors are concerned about their exposure to Canadian housing.

The greater the exposure to risky areas, the lower the valuation gets. Take **Home Capital Group Inc.**([TSX:HCG](#)) as an example, which lends primarily to high-risk borrowers in the Toronto area. Home Capital has been making a deliberate move towards uninsured loans, which come with a higher interest rate than loans that are protected from default by CMHC.

The problem with Home Capital might be its underwriting. The company admitted that close to \$1 billion of the loans it issued in 2014 may have been fraudulent, issued to borrowers who did things like falsify proof of their income. Upon further investigation, the company admits up to \$2 billion in loans might have been issued under false pretenses.

Although these loans are performing well, investors should really be treating them as toxic assets. Borrowers in Toronto have been helped by rising prices. What happens if prices turn flat or worse, start to head lower?

That risk is why Home Capital Group trades at a P/E ratio of just 7.1. When a company is viewed as the most risky of all the mortgage lenders, investors will avoid it and ask questions later. If the fear about the Canadian housing bubble turns out to be unfounded, the stock will eventually recover, and we'll look back at today as a buying opportunity.

Ultimately, an investment in real estate and especially Home Capital Group right now is a bet on real estate. I'm with Kevin O'Leary; I don't think it's a good place to be in the next five years. And if the naysayers are right, it could be very bad news for the sector in general, especially for risky lenders like Home Capital Group.

### CATEGORY

1. Bank Stocks
2. Investing

### POST TAG

1. Editor's Choice

### TICKERS GLOBAL

1. TSX:HCG (Home Capital Group)

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nelsonpsmith

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