



## Now's the Time to Short Home Capital Group Inc.

### Description

Mark Cahodes, the man who correctly bet against Lehman Brothers in 2008, believes Canadian housing prices, especially those in Vancouver and Toronto, are set for a fall; his bet to benefit from the end of the bull market in residential real estate in this country is to short **Home Capital Group Inc.** ([TSX:HCG](#)), Canada's largest non-prime mortgage [lender](#).

He makes a compelling case focused on three simple ideas: affordability, foreign money laundering, and a largely unregulated sub-prime lending industry.

### Affordability

Over the past 30 years housing prices in the Greater Toronto Area have increased by 188%, while incomes have risen just 1%, Cahodes told *Better Dwelling* magazine recently. He reckons that people buying homes simply can't afford to own them.

In Vancouver, where the average home goes for \$1.5 million, the average income of residents is \$80,000, meaning buyers are paying almost 19 times earnings just to get in on the great Canadian real estate bonanza. To the hedge fund veteran, that's simply nuts. Traditional metrics suggest a multiple of six times earnings is the upper limit when it comes to affordability.

Fool contributor Adam Mancini [recently](#) pointed out that the percentage of uninsured mortgages in Canada with a loan-to-value ratio of 450% or greater had increased by 500 basis points in 2015 to 24%.

If that doesn't shake you, nothing will.

Cahodes sees the "supply and demand" argument made by real estate professionals in Vancouver and Toronto as a specious one. He believes these two cities aren't the only places for Canadians to own homes. "Don't buy the supply demand noise," Cahodes told *Better Dwelling*. "There's plenty of places to build and live [in Canada]. It was the same story with Phoenix, Las Vegas, and Southern California when housing blew up here."

## Foreign money laundering

This is something mentioned by real estate professionals in both cities. While Vancouver has been the traditional beneficiary of foreign residential real estate investment, the same thing is happening in Toronto. In Vancouver, something like 5% of its total housing units, or more than 10,800, are currently vacant, much of it from condo investments made by residents of mainland China.

*Bloomberg* estimates that approximately US\$500 billion has moved out of China with much of it invested in Toronto and Vancouver real estate. Cahodes thinks the Chinese government could crack down on the flight of capital by convincing the Canadian federal government or B.C. provincial government to push for full disclosure of buyers and sellers of real estate.

By doing so, interested parties to this information, such as journalists, law enforcement, etc., would immediately know if money laundering was taking place from China and elsewhere or from illegal sources within our own borders. The loss of this business would exert significant downward pressure on real estate prices in both cities.

## Unregulated sub-prime industry

Cahodes uses the example of Home Capital Group's \$1.9 billion in fraudulent loans by rogue mortgage brokers as evidence that Canada's sub-prime mortgage industry is alive and well. He reasons that the 45 brokers should be named and punished by the Financial Services Commission of Ontario (FSCO), Ontario's regulator responsible for the mortgage broker industry in the province.

Worse still, most of the fraudulently obtained mortgages were CMHC insured, putting the taxpayer squarely on the hook for any mortgage defaults.

## Bottom line

Should you short Home Capital Group's stock as Cahodes has done for the past year? I wouldn't, but that's because I don't believe in the practice.

However, if you know what you're doing, there are few real estate stocks in Canada with as much to lose from a housing correction brought about by increased regulation. While the big banks will lose some, increased regulation could all but eliminate Home Capital's sub-prime business, the foundation of the company.

## CATEGORY

1. Investing

## TICKERS GLOBAL

1. TSX:HCG (Home Capital Group)

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