Why Is Genworth MI Canada Inc. Down 9.2%?

Description

It’s been a tough day for **Genworth MI Canada Inc.** (TSX:MIC), Canada’s largest publicly traded mortgage insurer.

The bad news started on Monday, when Finance Minister Bill Morneau announced a series of changes designed to cool Canada’s overvalued housing market.

The first step was to limit benefits for foreign owners of Canadian real estate. This included closing the tax loophole that let non-residents buy a property in Canada, declare it their principal residence, and pay no capital gains tax on the proceeds–even if they never lived there.

For the most part, people applauded this move; millions of Canadians believe non-Canadians are responsible for much of our housing bubble. Anything to limit these buyers is politically popular.

The other big announcement was the one that really hurt Genworth. Starting October 17, every new insured mortgage must be subject to a stress test that makes sure a borrower can pay their loan even if interest rates spike.

This will be accomplished by making borrowers qualify at the five-year posted rate, rather than the discounted rates most homeowners get. The difference is quite large. Mortgage rates of under 2.49% are common, while the new qualification rate currently stands at 4.64%, which is almost 100% higher.

This stress test was already in place for folks taking out variable rate mortgages and loans with a term of less than five years, but since approximately 80% of Canadians choose a five-year fixed mortgage, it wasn’t having the intended effect.

How this really affects Genworth

This change could be massive for the average wannabe homeowner. To put it into perspective, somebody who would have qualified for a mortgage worth $665,000 under the old rules would now qualify for a loan of just over $500,000. That’s the difference between buying and spending years longer as a renter–struggling to save up the required 20% down payment needed to avoid mandatory default insurance.

Genworth officially weighed in on the changes through a press release, saying that approximately one-third of mortgages insured thus far in 2016 would not be approved under the new rules, and many first-time homebuyers particularly would have problems qualifying under these new terms.

It gets worse. The company also said approximately 50-55% of the company's total insured mortgages–an amount that includes some $300 billion in loans over the years–would not have qualified for a mortgage under these new rules.

In short, Genworth is telling the market that while it supports moves to help protect Canada's real estate, it believes that the moves go too far.

Look at it this way. Genworth's overall portfolio of insured loans is performing well. Sure, there are a few defaults–especially in Alberta, which is struggling–but there are millions of Canadian homeowners who are paying their loans every month who would be shut out of homeownership with this new stress test. Is that really fair?

On the one hand, this should protect Genworth by making sure only well-qualified borrowers get loans. Even if we argue the government went too far with this batch of changes, at least we can all agree that anybody getting a mortgage after October 17 will be worthy of one.

But on the other hand, fewer mortgages means a bite out of Genworth's business, which gets paid each and every time somebody takes out a new mortgage. This is why shares are reeling, falling some 9.2% during early trading on Tuesday.

The bottom line

Over the short term, it's obvious that stricter mortgage rules will affect Genworth's top and bottom line. And with the company's investment income continuing to be low because of low bond rates, it's easy for bearish investors to sell their shares and get out. There isn't much to get excited about.

CATEGORY

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2. Investing

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