



Home Capital Group Inc. Receives \$3.5 Billion Lifeline

Description

Wow, what a crazy few weeks it's been for **Home Capital Group Inc.** ([TSX:HCG](#)); weeks like these haven't happened for Canadian lenders in a long time, and analysts and those who are bullish on the Canadian housing market and the alternative mortgage market in Canada are understandably stunned.

\$3.5 billion lifeline extended to stem material withdrawals of deposits

In a press release sent out early Wednesday morning, Home Capital announced it has come to a non-binding agreement with an unnamed lender for up to \$3.5 billion in emergency financing, secured against the business's portfolio of mortgages.

This credit line requires a commitment fee of \$100 million up front along with a required initial draw of \$1 billion at an annual rate of interest of 10%. This loan is intended to shore up the lender's short-term needs after Home Capital announced that during the four-week period from March 28 to April 24, nearly \$600 million in deposits were withdrawn from its high-interest savings account (HISA) holders. Home Capital's GIC deposits, which are locked in and generally much harder to withdraw from, saw approximately \$50 million of withdrawals during the same period, going from \$13.06 billion to \$13.01 billion.

Clarification

I would like to extend a thank you to Fool contributor Matt Smith, who [clarified an error](#) I made in a previous article; I'd said that Home Capital's cash balance and deposit levels were both liabilities. To clarify, it is true that GAAP requires that deposits are treated as liabilities and cash is treated as an asset.

My thesis for the article, however, was that the large cash balance that Home Capital held on its books should be viewed by an astute investor as a cause for concern (I should not have used the word “liability,” but rather “concern”), because the excess cash balance represents an opportunity cost for the business in that the excess cash, which was two to three times higher than what was needed to meet its minimum regulatory requirements, could have been invested in new loans at an average rate of 4.63% instead of sitting on the company’s books, earning nil.

I pointed out in the article that one of two scenarios is likely to be at play here: either the bank feels that it needs to keep a larger cash balance on its books due to the risk of its loans, which are not currently reflected in the provision for credit losses currently between 0.04% and 0.30%, or Home Capital is having trouble originating loans and therefore is forced to keep excess cash on its books.

I missed a third scenario, which appears to be playing out now: Home Capital may have anticipated the potential for a run on its deposits, and therefore wanted to keep excess reserves on hand to stem any material changes in deposits over the short term.

In terms of how the OSC conducts investigations, it is hard for me to believe that an investigation into Home Capital’s lending practices has not been under way for some time; materially misleading statements from a company’s officers typically results in further digging, although the OSC can neither confirm or deny such actions.

I would also like to clarify that I did not have enough room to go into detail on another major concern I had with Home Capital Group’s press release on April 22 in [this article](#): loan origination numbers. This is an article for another day; however, I would like to point out that while Home Capital pre-released its earnings-per-share numbers in its April 22nd press release, the company made no mention of origination numbers, which analysts and investors are clamouring for primarily due to the OSC-related scandal which has hampered the alternative lender for some time.

Bottom line

I’ve taken a very bearish stance against Home Capital for a long time for a number of valid reasons, and I try to share as much of my research I can with the Foolish reader; sometimes I miss things. This latest press release, however, speaks to the validation of many of the concerns I have written about with the HISA deposit holders, and to a lesser extent, GIC holders, who are anticipating the worst.

Stay Foolish, my friends.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:HCG (Home Capital Group)

PARTNER-FEEDS

1. Msn
2. Newscred

3. Yahoo CA

Category

1. Investing

Date

2025/08/03

Date Created

2017/04/27

Author

chrismacdonald

default watermark

default watermark