Will Home Capital Group Inc.'s Crisis Trigger a Housing Meltdown?

Description

By now, investors are familiar with the crisis that has engulfed Canada's largest non-bank mortgage lender, **Home Capital Group Inc.** (TSX:HCG). It is not only experiencing a massive run on call deposits, but it's facing a potentially even greater liquidity crunch as almost $13 billion in guaranteed investment certificates (GICs) start to mature.

Speculation that the collapse of one of Canada's largest non-bank mortgage lenders has triggered an fear across Canada and could be the spark required to burst what many believe is a massive housing bubble.

Now what?

As we all know, there have been claims that Canada is caught in a housing bubble of epic proportions for years. Despite repeated claims since at least 2012 that the market is in a massive bubble and ready to burst**,** nothing to that effect has occurred.

Alberta's housing market cooled significantly in the wake of the oil slump, whereas Vancouver's came off the boil after the introduction of a 15% tax on foreign house buyers. Ontario recently introduced a similar tax to rein in Toronto's frothy housing market; for April 2017, the average house price spiked by a massive 32% compared to a year earlier.

The greatest fear is that the collapse of Home Capital will trigger a rout in housing prices, particularly in overheated Toronto.

Home Capital's collapse would more than likely spark a significant reduction in mortgage lending**,** especially in the subprime or non-traditional lending space, which would certainly reduce speculation and some of the frothiness. This is because a lack of mortgages — especially for highly leveraged property speculators and subprime borrowers — would reduce the pool of buyers, reducing speculation and causing demand to fall.

Nonetheless, it's doubtful that it would trigger an all-out crash.

Prices in both markets are supported by shortages in housing stock and the fact that they are gateway cities, where many immigrants choose to live; this is leading to higher demand for housing.

There is also the lack of a clear mechanism to trigger the contagion needed, such as a large volume of non-recourse subprime mortgages, to cause prices to plummet at a calamitous rate.

Home Capital’s mortgage book, valued at just under $15 billion, represents only around 1% of Canada’s $1.5 trillion mortgage market. Even if the lender collapses, the impact on the housing market will be minimal.

Then there is the compulsory insurance for all mortgages that have a down payment of less than 20% and that are non-recourse. This means that should a borrower default, there is no need for the bank to immediately seize the home and sell it at a fire-sale price to recoup their funds.

Furthermore, the average loan-to-valuation ratio for the mortgage portfolios of the major banks is around 70% or less, which means there is plenty of wiggle room for borrowers and the banks alike should prices plummet.

For these reasons, it is unlikely that the rapid cascade of prices caused by ever greater quantities of repossessed homes coming onto the market, which was a key feature of the epic U.S. housing meltdown, will occur.

So what?

The crisis at Home Capital is very real, and while it will have sharp impact on its investors, there are signs that the contagion will be limited. Not only are there significant regulatory firebreaks designed to manage situations such as this, but tight prudential regulations mean that the fallout for the housing sector will be limited.

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Date

2025/08/10
Date Created
2017/05/08
Author
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