How Home Capital Group Inc. Differs From the Big Banks

Description

On Thursday, the Bank of Canada released a report on the financial system and Canada's housing sector as a sort of "health check" on the macroeconomic drivers of the Canadian economy and the broader risks facing the Canadian housing market and financial system overall.

The report has come as rapid price gains in major Canadian metropolitan areas such as Toronto and Vancouver have driven "extrapolative expectations" higher, leading to speculative buying of real estate in these cities and surroundings areas. The risks associated with rapid declines due to "adverse demand shocks" have led the Bank of Canada to issue a warning, although the central bank notes that such a risk is relatively low at this point in time.

In this warning, the Bank of Canada highlighted two key risk factors: rising consumer debt levels and a red-hot housing market which has grown increasingly unbalanced of late. While the report confirms that Canada's financial system remains robust and able to handle the risks associated with rising consumer debt levels and potential corrections in major Canadian real estate markets, the report focused on a few sub-segments of the Canadian lending space, namely alternative lending.

Canada's big banks are not the same as the alternative lending market

Canada's largest banks are very different from the country's alternative lenders from a business-operations standpoint as well as the underlying fundamental institutional structure of each respective bank category.

The way in which alternative lenders access the majority of the liquidity needed to make loans and maintain minimum liquidity ratios is the most important factor at the moment for embattled alternative lender **Home Capital Group Inc.** (TSX:HCG). In contrast to Canada's largest banks, which are able to raise liquidity in a number of ways, alternative lenders are typically forced to rely on "less-stable funding sources" such as deposits for the majority of their funding.

As Home Capital has seen of late with depositors pulling out of both high-interest savings account (HISA) balances as well as guaranteed investment certificates (GICs) en masse, the risk of a liquidity event for Canada's alternative lenders remains a significant challenge to firms such as Home Capital operating in this space.

Bottom line

One of the most significant risk factors for Home Capital has been for some time the ability of the lender to maintain solvency in a crisis of confidence. These risks have now been officially underscored by the Bank of Canada, and it remains to be seen if Home Capital will be able to secure more stable sources of funding in the near term.

Until that happens, I remain very bearish on the medium-term prospects of this lender moving forward.

Stay Foolish, my friends.

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