How a Vancouver Real Estate Crash Could Decimate Your Portfolio

Description

The numbers coming from the Vancouver real estate market keep getting worse and worse.

Just released April sales saw the worst results since 1995, and the benchmark price for the city has fallen nearly 9% from the peak in 2018. Listings are starting to languish on the market — something Vancouverites haven't seen in years.

Real estate bears are convinced this is the beginning of something much bigger. Even after the recent decline, Vancouver is still one of the most unaffordable cities in North America. Some families are even leaving the area in search of cheaper housing elsewhere. And anti-housing measures like a foreign buyers' tax and a tax on empty condos make potential bargain hunters a little wary.

If Vancouver's real estate market does collapse, how will it affect your portfolio? Let's take a look at two different banks that could take it on the chin.

Canadian Western Bank

Canadian Western Bank (TSX:CWB) is an Edmonton-based bank with operations primarily in Alberta and British Columbia. Although it doesn't break down loans to each individual area, we know it is highly exposed to the Vancouver real estate market. 34% of the company's $26.3 billion portfolio is loaned out against British Columbia real estate, which works out to some $8.9 billion worth of exposure to the province. And nearly half of the company's branches in the province are located either in Vancouver or its suburbs.

I'd estimate the regional bank has at least $4-5 billion lent out against houses in the Vancouver area. If that market takes a hit, so will CWB. It's that simple. A decline in the Vancouver market would also slow the company's loan growth, which has been a large overall driver to its bottom line. These decreased expectations could easily send shares lower before overall results show what's actually happening.

The good news is, CWB is a prime lender, meaning it focuses on the best clients. And remember, the riskiest mortgages are required to have mortgage default insurance, which protects the lender in the case of default. So, it’s unlikely even a major decline would push it to the brink of insolvency.

Before you go and short CWB shares, remember, the company pays a 3.6% dividend. Anyone who is short the stock is responsible for providing the dividends to the borrowed shares as well as paying for the right to do so. Shorting could get expensive in a hurry.

CIBC

Canadian Imperial Bank of Commerce (TSX:CM)(NYSE:CM) is Canada’s fifth-largest bank, the smallest member of the so-called “Big Five” Canadian banks. Saying CIBC is a small bank is doing the company a disservice, however. It has assets of nearly $600 billion and generated more than $5.2 billion in earnings in 2018. It also pays investors an attractive 5% dividend.

A consistent criticism of CIBC has been its over-exposure to the heavily indebted Canadian consumer. While the rest of its peers were busy expanding internationally, CIBC mostly stuck to Canada and focused on growing its operations here at home. This left it too focused on the Canadian economy and prone to risks like a decline in energy prices or a weak housing market. CIBC has expanded into the U.S. with the 2017 acquisition of PrivateBancorp, but critics argue it’s too little, too late.

The bank is a diverse lender with operations all across Canada. This means it isn’t overly dependent on one market, even an important one like Vancouver. The big thing that could impact shares would be if Vancouver’s weakness spreads across the country, especially to Toronto. CIBC can easily weather a few lean years in one market. A few lean years across the whole country would really impact the bottom line. Or perhaps a large decline in real estate triggers a prolonged recession. It doesn’t take a genius to figure out how that could be bad for a bank.

The bottom line

I don’t spend a lot of time stressing about a Vancouver real estate crash. Every market must take a breather now and again, and Vancouver remains a great place to live. But investors must remember that a declining real estate market touches every part of the economy. Perhaps today is a good time to be a little cautious.

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Date
2025/06/28
Date Created
2019/05/08
Author
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