DANGER: The Canadian Housing Market Crash Could Happen in 2020

Description

The days of easy credit are drawing to a close now that the Big Five Canadian banks are feeling the pain of provisions and overly complacent mortgage loans made in the credit upcycle when credit was all too easy. The mortgage stress test put in place around two years ago certainly doesn't bode well for continued appreciation in some of Canada's frothiest housing markets like Vancouver or Toronto, localities which many pundits see as being in bubble territory.

But with stricter credit from the banks, "easier" alternative lenders like **Equitable Group** and **Home Capital Group** (TSX:HCG) are stepping up to the plate to meet the appetite for mortgage loans. Although both alternative lenders are known to take on subprime customers, tighter credit conditions by the big Canadian banks bode well for credit quality, since the higher bar for bank loans has caused somewhat creditworthy lenders to head to the alternative lenders down the street.

While many see the Canadian housing market as the second coming of the events that led to the 2007-08 U.S. financial disaster, it's noteworthy that the circumstances on this side of the border are much different than in the U.S. before 2007. As such, the aftermath is unlikely to be the same. But as someone wise once said (believed to be Mark Twain): "History doesn't repeat itself, but it often rhymes."

In terms of easy credit, the situation may not be as bad, even with alternative lenders in the mix. But that's not to say that the housing crash will not be as severe. I see the Vancouver and Toronto housing markets as the bubbliest markets that could send shockwaves across Canada.

The two Canadian cities are home to some of the most overvalued markets on the planet, but it's not the inability of those with a mortgage to make their payments that'll trigger a crash (the expiry of mortgage teaser rates won't be the trigger as it was in 2007). Potentially escalating empty-home, foreign-buyer, and speculation taxes, among other stiff new taxes, could cause foreign speculators to sell their real estate and take their money to other markets.

Thus far, sales in such frothy markets have cooled off, but prices remain alarmingly high.

In time (perhaps in 2020), I see more pressure on regulators to pop the housing bubble itself before it has a chance to inflate further, as an entire generation has now been priced out of buying a home. If it means raising taxes to stop investors from viewing homes as mere investments for a portfolio, then so be it. Home affordability in select Canadian markets like Vancouver will remain a hot topic and only far lower prices will suffice, not just subtly slowing sales.

In any case, I wouldn't touch the alternative lenders like Home Capital Group at this juncture, because we may hear the keys jingle as prices in select Canadian markets finally begin to fall substantially. And if that happens, Warren Buffett may not be around for a bailout like the last time Home Capital fell into a tailspin.

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