Why This Mortgage Lender on the TSX May Be Volatile Right Now!

Description

The pandemic isn't over and the world isn't completely out of the woods but one of the most important benefits for consumers has ended. Six-month mortgage deferrals that began for consumers in March has come to an end in August. While the unemployment rates continue to remain high, there is a strong chance for mortgage defaults to rise in the coming months.

Gloomy predictions

A Q2 report by TransUnion Canada states, "Approximately 2.6 million Canadians (or 9.2% of credit consumers) have at least one active deferral, with higher-risk consumers more likely to be taking advantage of financial accommodation tools. 15.2% of Subprime consumers and 12.8% of Near Prime consumers have taken a deferral on at least one credit product or loan."

In May, Evan Siddall, president, and CEO of the Canada Mortgage and Housing Corporation (CMHC), had cautioned about the high number of deferrals. He had said, "We estimate that 12 per cent of mortgage holders have elected to defer payments so far, and that figure could reach nearly 20 per cent by September…. A team is at work within CMHC to help manage a growing debt "deferral cliff" that looms in the fall, when some unemployed people will need to start paying their mortgages again. As much as one fifth of all mortgages could be in arrears if our economy has not recovered sufficiently."

That's a huge number — and doesn't bode well for mortgage lenders like **Home Capital Group** (TSX:HCG). Now, make no mistake. The company reported great numbers for the second quarter of 2020 with earnings per share increasing over 20% to $0.65, and net income growing by 7% over Q2 of 2019.

The number of deferrals granted by Home Capital has also reduced significantly, from over 9,900 loans with a $3.9 billion principal balance as of April 30, 2020, to less than 2,700 loans with a principal value of $1.3 billion. That's a reduction of 73% in loan deferrals and a 67% reduction in principal value.

Will the mortgage lender outperform markets in 2020?

However, the second half of the year could be when trouble actually starts for Home Capital. The company claimed that unemployment rates for Canadians are unlikely to reach pre-pandemic levels until 2022. It also expects a decline in housing prices over the next 12 months due to a sluggish macro environment.

While lower housing prices could see a rise in people buying second-homes, it is very unlikely that first-time homebuyers will look at buying homes if the value of real estate is expected to fall.

According to a CMHC report, a first-time homebuyer who buys a $300,000 house with a 5% down-payment might lose over $45,000 on their investment of $15,000 if prices fall by 10%. These calculations also include mortgage insurance premiums and the costs of selling the house due to unemployment or other financial reasons.

The Foolish takeaway

I had written about Home Capital in June and cautioned investors against buying it. The stock has since appreciated over 20% since that article but my concerns still remain. What happens when the CERB comes to an end? Will there be a massive rise in defaults? Will the government step in with a slew of new assistance programs for consumers? It’s best to hold off until there are clear answers.

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