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Will 2016 be the year the Vancouver housing bubble bursts?

U.S. short-seller says signs point to a real-estate 'debacle' in Metro Vancouver

BY SAM COOPER, THE PROVINCE DECEMBER 20, 2015

STORY PHOTOS (2)

Debacle. Moral hazard. Creative destruction. Outspoken U.S. short-seller Marc Cohodes uses frightening words to describe his outlook for Vancouver real estate in 2016.

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Outspoken U.S. short-seller Marc Cohodes uses frightening words to describe his outlook for Vancouver real estate in 2016.

Since The Province's story in June featuring Cohodes — a prominent investor who bets on the collapse of speculative bubbles — the stock price of the Canadian subprime lender he is targeting has been cut in half. And that loss was despite double-digit price gains in Vancouver and Toronto homes.

But for several reasons Cohodes and a group of U.S. investors believe a rot of bad loans will spread and drag home prices down in 2016.

They believe their Canadian housing research was validated in December when the federal government announced policy changes aimed at reducing excessive borrowing and fraudulent loans.

The root of the federal government's concern is that housing prices, especially in Vancouver and Toronto, have soared far above wages in the past decade.

In addition to Ottawa's tightening mortgage rules — with CMHC requiring a 10 per cent down payment on the portion of mortgages it insures over $500,000 — Canada's Office of the Superintendent of Financial Institutions said mortgage fraud is a key threat to Canada's economy.

Among measures meant to reduce risks the office said it could require banks in Vancouver and Toronto to retain more cash. The idea is that bank capital hasn't kept pace with the relentless paper gains on the mortgages loaned. But if prices suddenly reverse banks will scramble to cover failed loans.

The result of increased capital requirements would be less money flowing into real estate. But banks will be less vulnerable to collapse and taxpayer-funded bailouts.

Cohodes believes Ottawa's unstated intent is to remove "moral hazard" — meaning risky financial behaviour encouraged by easy money and government-backed mortgages — from Canadian housing.

"What all this means to me is Canada is putting the risk back in the market," Cohodes said in an interview.

"But when you take the booze away after a 10-year party there will be a magnificent hangover. So I think 2016 will be a debacle. The speculators and money launderers will get burnt. But it will be good for younger people and the economy in the long-term."

As The Province wrote in June, Cohodes and other investors who warned of the 2008 U.S. housing crash are aggressively betting against Canadian lenders and the Canadian dollar.

Cohodes specifically targeted the massive Ontario-based mortgage lender, Home Capital Group. Two weeks after The Province's story was published, the company announced it was cutting ties with 45 mortgage brokers because of suspicious loans.

The company eventually acknowledged the group of brokers was responsible for $1.9-billion in mortgages, and its stock price fell from about $45 to about $25. The company says it is reviewing "income verification" on suspect loans and taking "corrective action."

Also, since June the Canadian dollar has collapsed as Cohodes and others predicted, tumbling nearly 20 per cent against the U.S. dollar.

The second factor Cohodes and similar analysts note is that interest rates were raised last week in the United States for the first time in 10 years.

Cohodes and others believe volatile market forces could push interest rates higher in Canada.

The consensus view among analysts is the Bank of Canada will not quickly follow the U.S. to raise rates, and may even be forced to lower rates. But it is difficult for Canada to diverge too much in monetary policy from its massive trading partner.

Cohodes says if the Canadian dollar continues to plummet the central bank may have to raise rates. A cheap currency is good for exporting businesses but inflates import good prices for Canadian consumers. Also, it is private lenders that ultimately determine how much risk Canadian consumers represent.

"If I'm looking at the average debt-laden Canadian consumer and considering a loan, why would I?" Cohodes said. "They will be charged more."

In December, the central bank said the average Canadian now owes $1.64 in debt for every dollar of wages, and the dangerous group that owes $3.50 for every dollar of income has doubled since 2005 to eight per cent of the population. Many of these most vulnerable borrowers live in B.C. and Ontario where housing prices are out of control.

However, the negative views of Cohodes and the U.S. short-sellers are seen as outlandish and self-serving by many Canadian financial professionals. Bryan Yu of Central 1 Credit says Ottawa's mortgage tightening rules are clearly directed at Vancouver's market, but will affect a relatively small group of borrowers.

"It is pretty clear CHMC (is) looking at controlling the risk for younger buyers but they are also looking at protecting against their own default risk," Yu said. "The market could cool but I don't think there will be a big impact in Metro Vancouver. I think low interest rates will prevail."

Bankruptcy trustee Blair Mantin of Sands & Associates says in the Fraser Valley he sees foreclosures rising quickly among condo speculators.

“For me the horse is already out of the barn,” Mantin said. “It’s too late, but I hope (CHMC mortgage tightening) will stop some people from jumping on the property ladder simply because they think they’ll be priced out.”

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