

Consumer Debt, Insolvency & Housing: The Turning of the Credit Cycle

Great Canadian Housing & Real Estate Conference



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Prudent Canadian Lending

- 1. Male, single, late 40s
House (semi): \$700K mkt value on 2 mortgages: \$310,000;
+HELOC: \$66,000
Credit card debt: \$155,000 (all the same bank)
Employment: Hospital Sanitary Engineer (14 years)
Income: \$3,700/mo net
- 2. \$263,000 in credit cards & UNS lines of credit (all Big 5 banks + a few retail cards). New to the country (3 yrs). The whole time here - on social assistance. Never employed. Living with family. Gambling issues.

Insolvency Canada 101 and ‘Drivers’

- HMA – about us
- Bankruptcies vs. proposals (and consumer vs business)
- The insolvency ‘cycle’ & legislative changes
- Macro econ (lag time, recessions)
- Seasonality
- Triggers/events – what gets you into my office (*sort of* in order):
 - Job loss
 - Illness
 - Marital breakdown
 - Student loans
 - Tax debt
 - Multiple Part-Time empl (& tax)
 - Self-employment (and taxes)
 - Having a family/cost of living
 - Eviction (a recent phenomenon)
 - Generally: Financial mismanagement/financial illiteracy
 - All of the above: **Relation to housing**

OSB Insolvency Statistics

(latest data July)

	Canada July '18 – July '19	Canada R12 July '18-'19	ON July'18-July '19	ON R12 July '18-19
Total Insolvencies	+17.2%	+6.5%	+22.5%	+9.5%
Bankruptcy	+3.8%	-2.3%	+2.6%	-0.3%
Proposal	+28.6%	+14.1%	+35.4%	+17.9

What Debts Go Away in Insolvency?

- ⦿ All unsecured debts (w/ some exceptions)
- ⦿ Credit cards, lines of credit, loans
- ⦿ Payday loans
- ⦿ Student loans > 7 years old
- ⦿ Personal guarantees on business debt
- ⦿ All tax debt: personal income tax, HST, PST & source deduction (director liability)
- ⦿ 407 highway debt
- ⦿ Utility debt
- ⦿ Secured debt shortfalls (car repos)/Mortgage shortfalls...

Recent Trends

- The road to debt (starting early) & habituation
- Debt normalization, especially depending on...
- Generations (millennials, seniors)
- Trends (more on this later)
 - Gender
 - Takes less debt to file insolvency now
 - Student debt
 - Tax debt (self-employment)
- Payday lending/installment loans
- “I should have come in 12-24 months ago”
- Credit score obsession
- Vantage point: creditor voting in proposals/lender tightening
- Evictions/renovictions
- THEME: housing costs

Mortgage Shortfalls in Insolvency

(Just walk away, Renee)

- Foreclosure/Power of Sale – provincial legislation (property)
- Canada known for being full recourse (except AB), BUT...
- **Any mortgage/HELOC shortfall is an unsecured debt now and is thus eligible for discharge via a bankruptcy or a proposal**
- Scenario:
 - Your house in Aurora drops 25% in value during a market correction; it's now worth \$860,000; you bought in late 2016 for \$1.2M
 - Spouse lost job & after trying everything, you start missing mortgage payments
 - The lender issues a notice to enforce security & house goes Power of Sale
 - There is a \$160,000 shortfall
 - That amount is now UNS & can be discharged by bankruptcy or a proposal
 - NO recourse to the lender in an insolvency proceeding
 - All other UNS debts are also discharged
- Further reading by Scott Terrio on this subject:
 - <https://www.macleans.ca/economy/realestateconomy/heres-how-canadians-could-walk-away-from-their-homes-if-house-prices-fall/>

Cost & Implications of Filing

(Previous scenario)

Door #1: Personal bankruptcy

- ⦿ Household: 5 people – 2 adults, 3 kids under 18 = surplus income threshold of \$4,644 net/mo
- ⦿ Income: \$5,800/mo net + EI (spouse) \$1,500 = \$7,300/mo
- ⦿ Daycare \$1,200/mo
- ⦿ Surplus income bankruptcy (1st time) $\$549 \times 21 = \$11,529$
- ⦿ Debt discharged: \$160K mortgage shortfall + \$80K in other UNS debt + \$5K CRA arrears = \$245K
- ⦿ Keep pension, RRSP, car (financed, so no net equity)
- ⦿ Credit impact: R9 rating for 6 years following discharge

Cost & Implications of Filing

(Previous scenario)

Door #1: Consumer Proposal

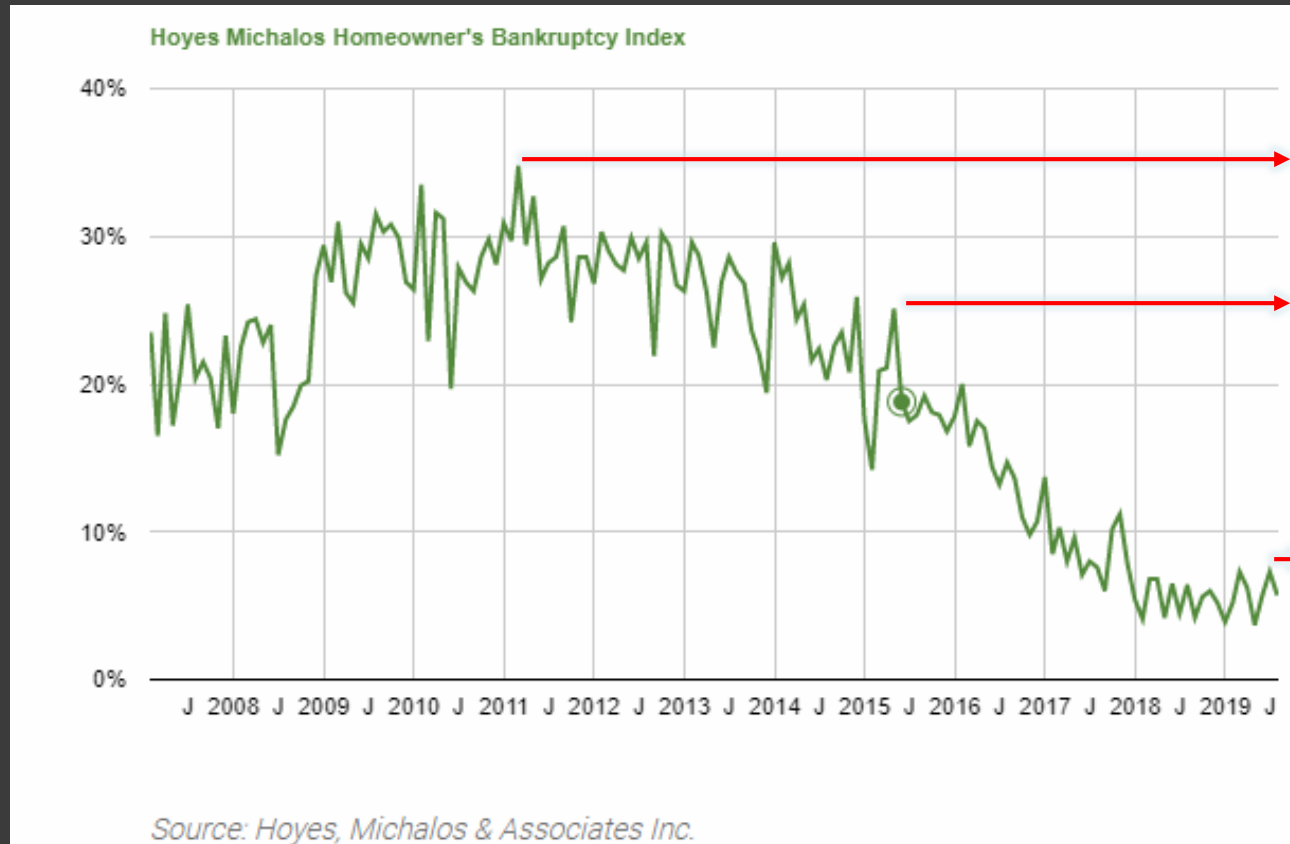
- Household: 5 people – 2 adults, 3 kids under 18 = surplus income threshold of \$4,644 net/mo
- Income: \$5,800/mo net + EI (spouse) \$1,500 = \$7,300/mo
- Daycare \$1,200/mo
- HYPOTHETICAL surplus income bankruptcy (1st time) =
 $\$549 \times 21 = \text{\$11,529}$
- Proposal offer: \$800-900/mo x 60 months = \$48-54K
- All interest stops, terms fully open
- Debt discharged: \$160K mortgage shortfall + \$80K in other UNS debt + \$5K CRA arrears = \$245K
- Keep pension, RRSP, car (financed, so no net equity)
- Credit impact: R7 for maximum 3 years after last proposal payment

HoldCo – Insolvency Implications

- ◎ Real estate speculators who own holding corps:
 - Run into trouble:
 - -ve equity &/or -ve cash flow on rental properties
 - in too deep (multiple properties, -ve cashflow \$2-5K /mo)
 - Close down the corp (any corporate tax dies, as do any other corp. debts) & file a personal matter (bankruptcy or proposal) on all tax debt - cap gains, HST, etc.
 - Include all personal unsecured debts
 - All UNS debts legally released

Hoyes Michalos Homeowners Bankruptcy Index

- Only 5.7% of our current insolvency files are homeowners (July 2019)
- *Last statistically significant high was 27% in 2015



Feb. 2011:
34.8%

Apr. 2015:
25.1%

*July 2019:
5.7%

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Hoyes Michalos Homeowners Bankruptcy Index

(So, what does that even mean?)

- Historic lows (from 34% down to 5.7%)
- Decline in homeowners filing insolvency not due to lack of UNS debt; in fact, as seen previously, they have much more credit card debt than renters
 - Avg min payments on \$72,510 in UNS debt: **\$1,841 /mo total**
- Rising home prices have created a great prolonging effect
- Four factors that increase risk of insolvency for homeowners:
 - Rising interest rates
 - Falling home values
 - Credit tightening (the cycle)
 - Rising unemployment
 - (Bonus factor: refinancing rejections - trend)

If so few homeowners file insolvency, then who cares?

- Lack of awareness of insol. options – only thing holding it back
- Next insol. wave: est. 150-200k files/yr, 3-5 years long = 450-1M
- Expect homeowner index back up to 20% = 90-200k homeowner filings – much more if people knew their options
- \$72,510 homeowner UNS debt scenario (HMA study):
 - Current mo. UNS min. payments **\$1,841** (w/ interest)
 - Assume no equity & mo. net inc \$7,300 (family of 4):
 - Surplus inc bankruptcy: **\$703** x 21 months = **\$14,763**
 - Consumer proposal: **\$300** x 60 months = **\$21,000**
 - (both cases keep house)
 - Assume \$100,000 net equity:
 - Bankruptcy: must pay equity to trustee, so **\$72,510** (**\$3,452/mo** x 21)
 - Proposal: 60 months to pay \$72,510, so **\$1,208/mo**
 - (both cases, keep house)
- KEY: homeowners saddled w/ UNS debt have options to pay debt & keep their homes

Recent Trends

- ⦿ Creditor voting in proposals
- ⦿ Millennials: now fastest-growing debtors by age cohort
- ⦿ (2nd fastest is seniors)
- ⦿ Student loan debt increase
- ⦿ Lenders tightening up
- ⦿ Self-employed (tax debt)
- ⦿ Evictions/renovictions
- ⦿ THEME: housing costs

Forecast/Conclusions

- HOUSING EFFECTS ON CDN DEBT:
 - Canada skipped a natural debt reckoning c. 2014/15
 - Consumers binged on debt enabled by low rates & housing boom
 - Liquidity?
 - Youngest Cdns: unable to buy a home, can't afford rent driven up by boom
 - Boomers/seniors hanging onto homes; equity tied up
 - Gen X/Y: sandwich generation; strapped during peak earning years

Further Reading/Resources

- Scott Terrio: Publications & media appearances
 - <https://www.macleans.ca/opinion/why-a-low-delinquency-rate-isnt-the-good-news-real-estate-story-you-think/>
 - <https://www.macleans.ca/economy/realestateconomy/heres-how-canadians-could-walk-away-from-their-homes-if-house-prices-fall/>
 - <https://www.macleans.ca/news/canada/drowning-in-debt-is-the-new-normal-in-canada/>
 - <https://www.macleans.ca/economy/money-economy/these-are-the-most-common-myths-about-bankruptcy-in-canada/>
 - <https://www.macleans.ca/economy/realestateconomy/how-canadian-homes-became-debt-traps/>
 - <https://www.bnnbloomberg.ca/personal-finance/video/when-a-cash-strapped-household-may-be-carrying-too-much-insurance~1534072>
 - <https://www.bnnbloomberg.ca/video/digging-out-of-debt-real-life-scenarios~1315401>
 - <https://www.hoyes.com/blog/consumer-insolvencies-are-both-seasonal-and-cyclical-whats-trending-more/>

- General bankruptcy and debt information:
 - www.hoyes.com
 - www.bankruptcy-canada.ca
 - www.moneyproblems.ca

- Commentary:
 - www.hoyes.com/blog/
 - www.bankruptcy-canada.ca/trustees-talk/

Miscellaneous

- ◉ Fleeing from debt
 - ◉ HELOCs
 - ◉ Rule of Offset
- ◉ Joint debt/co-signing
- ◉ Debt mgmt. companies
 - ◉ Debt consolidation
- ◉ Private debt settlements
- ◉ Managing debt between jobs
 - ◉ Death & debt

Bankruptcy Myths

- I will lose my home
 - I will go to jail
 - I will lose my stuff
 - I will lose my job
- My spouse will be impacted
- I will never be able to buy a house (get credit, etc.)
 - I will not be able to renew my mortgage
- But my brother the cop told me taxes can't be included
 - What if win the lottery?
 - My trustee will restrict my income
 - Mortgage shortfalls can't be included



Types of Debt

Detailed Information on the amount of average unsecured debt:	2018	2017
Personal loans	\$16,944	\$17,520
Credit cards	\$15,905	\$15,134
Taxes	\$8,835	\$8,797
Student loans	\$2,597	\$2,089
Other	\$5,008	\$5,531
Filed bankruptcy	36%	39%
Filed consumer proposal	64%	61%

Most Common Creditors

Overall (in order):

- Big 5 banks
- CRA
 1. income tax
 2. HST
 3. source deduction
- Capital One
- CanadianTire
- Student loans
- MBNA
- PC
- Payday loans (esp. inst. loans)
- Easy/Fairstone
- Walmart
- Utilities (Bell, Rogers etc.)
- (RECENT TRENDS)

Within Big 5 Banks (in order):

- RBC
- TD
- CIBC
- BNS
- BMO