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Home Capital rebounds as it firms up line of credit, looks at possible sale

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Home Capital Group Inc. shares roared back Thursday, as the beleaguered mortgage lender firmed up an emergency multibillion-dollar loan and signalled that it may sell itself.

The stock closed up 34 per cent on the Toronto Stock Exchange, its biggest one-day increase in more than 20 years, as some investors wagered that the company is regaining its financial footing – at least for the time being.

The sharp rebound in the stock came the day after its biggest fall in history. Home Capital lost 65 per cent of its value on Wednesday, in part because of doubts over the company's long-term viability and its ability to fund itself.

"We are taking important steps to seek to stabilize the business," Kevin Smith, chairman of Toronto-based Home Capital, said in an e-mail to The Globe and Mail. "As rough as the past few days have been, we are very focused on getting this company back on track and doing everything we can to make that happen."

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Home Capital is a relatively small mortgage provider; with about $18-billion in assets, it is a fraction of the size of any of the major Canadian banks. But it is a significant player in the market for mortgages to consumers who cannot qualify for a mortgage from a bank. Its financial troubles come at a time when there is heightened scrutiny on the real estate market because of rapidly-rising prices in the Greater Toronto area and still-high price levels in Vancouver.

In a release on Thursday, the company said it had a firm commitment on a $2-billion credit line with a 10-per-cent initial interest rate and a $100-million initial fee from a "major Canadian institutional investor."

On Thursday evening, the Healthcare of Ontario Pension Plan (HOOPP) said that it would be one of a syndicate of lenders that would provide the secured line of credit. HOOPP counts 321,000 Ontario health-care workers and retirees as members and has about $70.4-billion in assets. The pension plan has a department that makes corporate credit investments.

The report of HOOPP's involvement initially raised questions about how potential conflicts of interest would be managed. The pension plan's chief executive officer Jim Keohane became a director of Home Capital about one year ago and sat on Home Capital's risk and capital committee. And Home Capital's board chair Kevin Smith, who also works as CEO of St. Joseph's Health System and Niagara Health System, held a position on HOOPP's board.

But a source familiar with the matter said Thursday night that both men had elected to give up their respective board seats as a result of the financing agreement and the new relationship forged between the pension plan and the mortgage lender.

A representative for HOOPP declined to comment specifically on how the pension plan assessed the merits of the investment. But the fund said in a statement that “like any investment, this decision was made in the best interest of our members’ financial needs. We have a long history of providing these types of investments as appropriate, risk-balanced vehicles to meet our overall return targets. This investment followed all the appropriate due diligence.”

Canada’s biggest alternative mortgage lender reiterated on Thursday that it needed the fresh infusion of funds to mitigate the recent sharp drop in high-interest savings account deposits – an important source of funding for mortgages.

High-interest savings deposit balances plummeted to roughly $814-million as of Wednesday, from $1.4-billion on Monday, the company said. A month ago, that balance stood at just under $2-billion.

Of potentially greater concern is the roughly $13-billion Home Capital has in fixed-term guaranteed investment certificate GIC deposits. Analysts point out that half are due to mature over the next year – at a rate of roughly $600-million a month. With many of Canada’s big banks now limiting sales of such instruments to their clients, the risk is that Home Capital sees a significant drop-off in GIC deposits that puts further pressure on the company’s ability to fund itself.

Analysts speculated that the cash infusion from institutional investors would not last long for Home Capital. ***Veritas Investment Research*** analyst ***Mike Rizvanovic*** figures it “at best gives Home Capital a one- to two-month stopgap.”

“Two billion is a lifeline,” National Bank Financial analyst Jaeme Gloyn said in an interview. “But history would suggest that lifelines like these are not lifelines. We’ll see.”

Home Capital said Thursday that it has retained investment banks RBC Dominion Securities Inc. and BMO Nesbitt Burns Inc. as financial advisers as it considers strategic options.

Mr. Gloyn said a possible buyer of the company could be a life insurance company, pension fund, or U.S. or Canadian private equity firm.

Mr. Rizvanovic, however, isn’t optimistic the company will be sold outright, saying it’s difficult to see the rationale for someone to buy a mortgage company that is unable to fund itself.

“If they can’t access the deposit market, then there’s no value in the Home Capital entity,” he said, adding that a strategic buyer, such as Laurentian Bank of Canada or Canadian Western Bank, would be better advised to buy only the mortgages and roll them into their own network.

A Laurentian Bank spokesperson told The Globe in an e-mail that the bank does not comment on rumours. A Canadian Western Bank spokesperson declined comment.

Another worst-case scenario being floated by analysts is an eventual forced windup of the company under the supervision of the Office of the Superintendent of Financial Institutions (OSFI), the banking regulator.

“It will depend on whether the market settles down,” ***Mr. Rizvanovic*** said. “If there’s a lot of contagion, and fear, I think OSFI will be more inclined to step in earlier rather than later.”

“OSFI is continuing to monitor the situation closely,”Annik Faucher, spokeswoman with OSFI, wrote in an e-mail to The Globe.

On Thursday, Standard & Poor’s downgraded the firm’s debt to “speculative” status from “investment grade” citing “operational and liquidity” concerns.

On Wednesday, fellow rating agency DBRS Ltd. also downgraded the firm’s debt, citing “heightened pressure on Home Trust Company’s funding and liquidity profile.”