Can Home Capital 'plug the gap' with $2B from HOOPP?

Sara Tatelman | May 1, 2017

As Home Capital Group Inc. grapples with plunging share prices and large withdrawals in quick succession, the Healthcare of Ontario Pension Plan has inserted itself into the uncertainty by offering financing to the beleaguered mortgage lender.

But is the move a bad business decision by the pension plan?

"Investing is a very complicated business, but I think the people at HOOPP are as good as anyone else at investing," says Joe Nunes, president of Actuarial Solutions Inc. "I'm assuming they've done the homework and they've recognized the risk and they've probably recognized it as an organization that needs some cash and [HOOPP has] cash and they're able to help out."

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Last week, Home Capital announced the pension fund was leading a $2-billion line of credit, secured against a portfolio of mortgages, to the company that would charge 10 per cent interest on outstanding balances and 2.5 per cent interest on undrawn amounts. The mortgage lender must withdraw at least $1 billion and pay a $100 million commitment fee.

"To get an immediate $100 million on a potential $2-billion loan, plus a 10 per cent interest rate, it smells like something Warren Buffett would do," says Jonathan Jacob, senior vice-president of quantitative research and risk management and head of portfolio risk solutions at Greystone Managed Investments Inc.

In a press release, Home Capital said it expected to receive $1 billion from the credit line on Monday. "Access to these funds is intended to mitigate the impact of a decline in Home Trust's high interest savings account deposit balances," it noted.

The pension fund is betting the $2-billion loan will be sufficient to "plug the gap" that has arisen between Home Capital's liquid and illiquid assets, says Jacob. "So the people who have lent them money have the right to ask for that money back whenever they want. The people who have borrowed money from them don't have to pay it back upon request. So that's the problem. Basically, all the depositors are asking for their money back and the mortgage borrowers that they've lent to don't have to repay until the mortgages come due."

Read: HOOPP's chief executive quits Home Capital Board, citing potential conflict

Another concern are potential conflicts of interest. HOOPP president and chief executive officer Jim Keohane resigned as a board member of Home Capital and two of its subsidiaries last week. Home Capital chairman Kevin Smith has also resigned as a director at the pension fund.

"Did [Keohane] know things that made it easier to extend that type of loan? Perhaps," says Jacob.

"It doesn't appear completely snowy white, let's say, but I don't think anybody's done anything that could be said is really fraudulent or criminal or wrong," he adds.

Jacob also hypothesizes regulators are "convening emergency meetings now" to determine what might occur if the $2-billion loan isn't enough. While he's hopeful the financial uncertainty won't spread beyond Home Capital, "it might be worthwhile to review some of the practices that led to this situation. So if there were issues with mortgage brokers, let's have an honest investigation of how we got there and make sure the regulators are aware so we don't go down this road again with another institution."

Note: This story was updated at 11:30 a.m. on May 5th to clarify Nunes's quote.