



## Canada seen as next hotbed for subprime mortgages

Unfazed by the subprime meltdown in the U.S., lenders are turning to Canada

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At first glance, there is neither rhyme nor reason why Canada's financial markets should have taken such a beating over the subprime mortgage meltdown wreaking havoc in the United States. But there is no controlling fear when the pocketbook is threatened. It's the old story repeating itself; Uncle Sam burps and we get indigestion.

The distress in the U.S. housing market, caused by lenient lenders with more money than sense, is hitting Americans where it hurts them the most. If now they slash their spending habits, the retail sector will get knocked for a loop and Canada's manufacturing sector and export industry will feel the brunt of it, says Paul Ferley, assistant chief economist at BMO Capital Markets.

That wasn't in the cards last week when HSBC Holdings, Europe's biggest bank, with about 125 million clients worldwide, reported it had lost \$10.6 billion US on bad debts related to subprime mortgages, much greater than Wall Street's worst expectation.

Tumbling financial markets in Southeast Asia overshadowed that development. But forget China and the Far East; this problem is a lot closer to home, and Canadians will be made aware of this as U.S. subprime lenders come here in far greater numbers than they already have.

And they are coming.

"Subprime in Canada is the next real big wave of business," says Michael Hapke, managing partner of Mortgage-Brokers.com in Ottawa, which has offices nationwide. "We're years behind with the subprime market, but the U.S. mortgage lenders who handle this business are starting to pour in. Some of them have been around a long time and have done very well because they've opened the door for many homebuyers."

The inherent danger with subprime mortgages is that they carry the risk of loan defaults and mortgage underwriting among buyers with less-than-stellar credit who are encouraged to take loans far beyond their financial means.

The lenders do this by offering adjustable-rate loans that carry introductory rates that keep payments relatively low for two years. The idea is that if borrowers can't

afford to make the increased payments at the end of the initial two-year period, they will refinance with new loans, supported by the increased value of their home.

That's all well and good in a housing market with rising prices. What few foresaw was the bursting of the U.S. housing bubble. That has left tens of thousands of borrowers with rocketing mortgage payments, up to 40 per cent greater, who are now either unable or unwilling to make payments on a property worth far less than what they paid for it.

While damage to financial markets is incalculable, the U.S. Centre for Responsible Lending estimates that approximately \$1 trillion US in subprime mortgages are in default and one in five of the subprime loans written in the past two years is headed for default, costing 1.1 million families their homes and unleashing a flood of foreclosed properties on the market.

Hapke says that exposing Canadian homebuyers to subprime mortgages carries the same risks.

"But big companies don't care too much about the overall economy. They're more interested in hitting the market while it's hot. In terms of where the mortgage market is going, subprime is where it's headed. The majority of our business going forward will be there.

"There's no question it's dangerous, but those dangers could be 10 years down the road and you know what industry's like. The companies insuring these mortgages are very aggressive. They're interested in growth now. They're not interested in 10 years down the road."

What's happened in the U.S. subprime business confirms this. Dozens of subprime lenders have closed, scaled back or been sold over the past 15 months.

Shares of New Century Financial Corp., of Irvine, Calif., the second-biggest U.S. home lender in the business, have crashed to \$1.66 US from \$51.97. The New York Stock Exchange has suspended trading in the shares, the company says it doesn't have enough cash to pay its own lenders, it has been subpoenaed by a grand jury in a federal criminal probe and is expected to file for bankruptcy protection.

Shares of Accredited Home Lenders Holding Co., parent company of Accredited Home Lenders Canada Inc., crashed 65 per cent on Tuesday.

Countrywide Financial is down nearly 30 per cent. Fremont General Corp. has agreed to a cease-and-desist order with bank regulators that requires it to stop advancing risky mortgages. Fremont says it plans to exit the subprime home-loan business.

Among the listed companies on the Toronto Stock Exchange that handle subprime mortgages are Home Capital Group Inc. (HCG), Equitable Group Inc. (ETC) and Xceed Mortgage Corp. (XMC).

Xceed bills itself as a "non-traditional residential mortgaging company" with a main client base of "non-traditional customers who are unable to satisfy the strict

underwriting criteria of traditional mortgage lenders."

Xceed is trading around \$6.45, about 37 per cent off its 52-week high.

In England, where subprime mortgages are popular, the financial market wasn't immediately disturbed by events in the U.S.

Miray Muminoglu, a syndicate banker at Barclays Capital in London, told Bloomberg News, "The stock market is in solid shape. There's no fear of contagion from the U.S. and further proof that the U.K. is a different market."

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