Will the Housing Correction Bury Alternative Lenders?

Description

The drip, drip, drip of new housing data has begun to reveal a clearer picture in light of the Ontario government's moves to cool the market.

Data from the Canadian Real Estate Association showed that sales fell in 16 of 26 major markets in June. This represented a 6.7% drop — the largest decline since 2010.

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The Toronto Real Estate Board reported an average sale price of $760,356 in the first 14 days of July, down from the high of $919,589 seen in April. Sales volumes have dropped 39% from the same period in 2016. It is important to note that the Bank of Canada raised its base rate on July 12, so the effects of the rate hike may not be present in these numbers.

Canada's banking regulator OSFI has proposed stress tests for uninsured borrowers; purchasers will pay 20% down or more for a property. With the plunge in housing sales and prices, economists have indicated that regulators should consider applying the brakes to avoid a more severe correction that has the potential to be destabilizing.

Will these developments affect alternative lender stocks?

Beleaguered lender **Home Capital Group Inc.** (TSX:HCG) had a bumpy start to the trading day Monday, at one point falling below the $13 mark. It fought back to close at $13.51 — gaining 1.5% for the day. Since the Bank of Canada punched in its rate hike, Home Capital has declined 5% with investors still expressing skepticism with regards to the company.

Home Capital's customer base is more vulnerable to variable rates than borrowers at the big banks. Purchasers with Home Capital could potentially see their rates rise in the double digits. HELOCs may be harder to come by with the loan-to-value ratio of recently purchased homes hit by collapsing prices. This could limit the financial maneuverability of recent home buyers.

The share price of **Equitable Group Inc.** (TSX:EQB) has also declined since the rate hike, though marginally. On Monday, the stock saw an increase of 1.29% — closing at $54.80.

Equitable Group is set to release its quarterly earnings on August 10. Analysts are expecting an increase to its earnings per share between 10% and 15%. The company recently announced a dividend of $0.23 per share with a dividend yield of 1.67%.

The rate hike had an early impact on Home Capital and Equitable Group shares, though both have resisted the downward pressure as investors wait for quarterly earnings to be released. Falling housing prices do not appear to be worrying the market too much as of yet, but it is early in the correction and the overall picture is incomplete.

Industry leaders and economists are confident in the overall health of the real estate market, citing high demand and general economic strength. Investors should be exercising extreme caution during this period when it comes to both of these companies, especially after valuations for both have benefited from a recent bump after Warren Buffett’s Home Capital purchase.

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