3 Reasons Home Capital Group Inc. Could Decline Further After a Second Rate Hike

Description

Shares of **Home Capital Group Inc.** (TSX:HCG) declined 2.84% on September 6 as the alternative mortgage lender digested news of the Bank of Canada's decision to raise interest rates to 1%. Home Capital Group has fallen 28% since it received a boost on June 22 from Warren Buffett's vote of confidence in the company. There has been a rise in optimism after the company underwent an internal transformation and overhauled key leadership roles, including the introduction of a new CFO on August 29.

However, the company still has some major hurdles to overcome as it heads into the closing months of 2017.

Bleak conditions in the Toronto housing market

The Toronto Real Estate Board released sales numbers for August 2017 that showed a 34.8% decrease from the same month in 2016. New home listings fell 6.8% to the lowest levels seen since August 2010, possibly due to seller withdrawing from the market in response to falling prices. Home prices were up 3% from August 2016, but down 20.5% from the peak seen in April of this year. Market analysis from the TREB indicated that these more "balanced" conditions could lead to accelerated growth in the fall.

New mortgage regulations

The Canadian Mortgage Brokers Association penned a letter to the OSFI in September suggesting revisions to the Guideline B-20. The changes in the guideline included stringent stress tests for uninsured mortgages, a requirement that loan-to-value measurements adjust for local market conditions, and prohibition of co-lending agreements designed to circumvent regulations.

The CMBA suggested several tweaks to B-20, including stipulations that allow lenders to continue to bundle first and second mortgages, permitting qualification at a contract rate associated with a five-year fixed term, and issuing the same qualifying rate for insured and uninsured mortgages.

In its second-quarter earnings report, Home Capital Group acknowledged that the regulations proposed by the OFSI had the potential to slow sales growth.

Customer exposure to higher rates

Perhaps the greatest fear for markets is the near-record high debt-to-income ratio seen among Canadian citizens. The big banks responded to the interest rate increase by raising base lending rates. As an alternative lender, Home Capital Group customers are more susceptible to base rate increases and, in some instances, could see variable rates on mortgages rise by double digits.

A survey from the Canadian Payroll Association released on September 6 showed that 47% of Canadian employees would have difficulty meeting financial obligations if paycheques were delayed by just a week. Higher living costs was the most common reason for the increased spending. The numbers for millennials and generation Xers were troubling, as 55% would experience a crisis if one paycheque was missed.

The survey, and several others released in 2017, demonstrate the precarious situation many Canadian citizens find themselves in. When raising the rate, the Bank of Canada also emphasized caution, which may indicate a slowdown in rate acceleration heading into 2018.

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