Will Housing Stocks Heat Up in the Spring?

Description

In the midst of the steep housing correction in the summer of 2017, real estate industry experts were already throwing out projections for 2018. The consensus from the sector seemed to be that new OSFI mortgage rules would dramatically cool sales and prices to start the year before the market began to re-balance in the spring season — typically the busiest season for home sales in Canada.

Toronto new-home sales were down 48% from January 2017 to January 2018, according to the home builders' association. This represented a 31% drop from the 10-year average. However, this supply shortage has also pushed up home prices year over year, with the single-family benchmark home prices rising 19.6% year over year. A recent **Canadian Imperial Bank of Commerce** report was reasonably bullish on housing due to the supply issue that has no real resolution in sight.

The issues with supply in Canada's major metropolitan areas has come to the forefront of late. Evan Siddal, the head of the Canada Mortgage and Housing Corporation (CMHC), recently said, "If I were concerned about anything from a long-term housing market point of view it's the supply of housing in Toronto and Vancouver." Data released by the CMHC showed 20 new homes built for every one demolished in 2016 compared to a 70-1 ratio at the beginning of this decade.

The Ontario government has projected that the population in the Greater Toronto Area will rise to 9.6 million in 2041 from 6.5 million in 2016. Dave Wilkes, the CEO of the Building and Land Development Association (BILD) raised concerns over lack of supply. "A healthy new home market should have nine to 12 months of inventory," BILD said in a press release.

Real estate lender stocks have been pummeled to start 2018. This is due in part to housing bears, but rising interest rates have also produced anxiety over industries that rely on what has been a cheap credit environment since the financial crisis.

Equitable Group Inc. (TSX:EQB), a Toronto-based financial services company that provides mortgage lending products, has seen its stock fall 14% as of close on February 28. Equitable Group released its 2017 fourth-quarter and full-year results on the same day. Net income rose to a record $160.6 million, which represented a 16% jump from 2016. Mortgages under management also climbed to a record $23.2 billion — an 11% increase from the prior year. Equitable Group also hiked its quarterly dividend to $0.26 per share.

Shares of **Home Capital Group Inc.** (TSX:HCG), another alternative lender, have dropped 8.7% in 2018 thus far. The company released its 2017 fourth-quarter and full-year results on February 15. Net income rose 2.1% from the previous quarter and total mortgage originations jumped 126% from Q3 to $872.1 million. Results were still down significantly from the prior year, as Home Capital has undergone a dramatic internal restructuring after nearly collapsing in the spring of 2017.

Of the two, Equitable Group continues to stand out as the more attractive option. Its earnings have been consistently positive, and it offers a solid dividend. However, investor sentiment and rising interest rates could weigh on housing stocks for much of 2018.

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