How Will the Recent Changes to Mortgage Regulations Affect Equitable Group Inc.?

Description

This year should prove to be interesting for alternative lenders like **Equitable Group Inc.** (TSX:EQB) thanks to recent actions taken by governments to curb household borrowing in Canada.

Across all levels of government, politicians in the country are focused on making sure that the Canadian housing market doesn't get out of control, as was the case in the United States a little more than 10 years ago.

To date, there have been several restrictive prohibitions put in place, including reducing the length of time a borrower can amortize their mortgage and lowering the amount a homeowner can borrow against their home in refinancing, but perhaps the biggest test will be the recently enacted "B-20" Guidelines.

There are several changes that will come forth with the new regulations, but the most notable change will be a new requirement that all mortgage applications — including those with down payments greater than 20% of a home's value — will need to undergo a series of "stress tests."

The new stress tests are designed to measure whether a prospective borrower will remain able to service their debt not only in the current environment, but also if rates were 200 basis points, or 2%, higher than the levels in place when the borrower applies for their loan.

Only time will tell how the changes shake out in the marketplace, but some experts are suggesting that perhaps as many as 10% of uninsured mortgages that were approved between 2016 and 2017 would not have been approved under the new system.

There are also some suggesting that under the new rules, prospective homeowners may be forced to settle for a property that is some 20% cheaper than what they would have been able to afford under the old system.

What is the expected impact on Equitable Group?

Equitable Group is forecasting that loan originations will slow in 2018 and may even shrink from previous levels.

To be clear, the company is still expecting its loan book to grow in 2018, as it will continue to add new clients to its business; it's just that the pace of that growth will likely not be the same as in the past.

In its 2017 annual report, Equitable Group estimates that certain segments of the real estate market that have been its clients in the past may be eliminated from participating in the market.

Yet there is a silver lining in all of this: because the new regulations will make getting a new loan more difficult, it will serve to make it easier for lenders like Equitable Group to retain their existing books of a business — definitely a good thing for a company that may face challenges in attracting new business.

What should you do?

Despite having a strong track record of operating performance, Equitable Group's shares still trade at a sizeable discount to the market.

For a company which has grown its shareholders' equity by 84% over the past five years and which generated returns on equity of 15.8% in 2017, the company's shares almost inexplicably trade at just 0.83 times book value on the company's balance sheet — a conservative measure used by many value investors.

Despite the headwinds forecast for 2018, Equitable Group's shares present as a compelling investment opportunity, but one would be remiss not to mention that when Warren Buffett made his foray into Canada's alternative lending space in 2017, it wasn't Equitable Group that he bought a stake in, but rather one of its nearest competitors, **Home Capital Group Inc.**

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