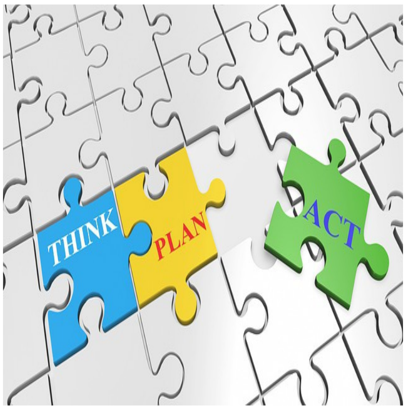

Is it Finally Safe to Jump Back Into Alternative Lender Stocks?

Description

When new OSFI mortgage rules were announced last year, alternative lenders were quick to warn investors that a period of slow loan growth could follow. In the second quarter of 2017, both **Equitable Group** (TSX:EQB) and **Home Capital Group** (TSX:HCG) warned in their respective quarterly reports that new rules would limit growth but would also improve retention rates.

Back in early August, I'd discussed a report from Mortgage Professionals Canada that said about 100,000 Canadians had been prevented from buying a home due to the new rules. New CMHC rules are being introduced in October that are designed to give more leeway to prospective buyers who are self-employed. There is increasing pressure on policy makers, as Canada faces down an affordability crisis in housing.

This crisis will likely be exacerbated as Canada pushes forward with record immigration levels, while housing supply remains low in major metropolitan areas. Those in the industry have witnessed double-digit percentage declines in housing sales year over year, but prices have continued to inch up. According to Statistics Canada, Canada's population grew by 168,687 in the second quarter of 2018. This was the largest quarterly increase ever recorded.

By contrast, Canada will struggle to construct 200,000 housing units by the end of 2018. This squeeze will make it difficult for the government to incentivize affordable housing development. It will also be a ripe environment for steady price increases so long as the discrepancy between immigration levels and housing supply remains.

Is this good or bad news for alternative lenders?

Equitable Group stock was down 3.4% as of close on September 27. Shares were still up over 20% year over year. Its third-quarter results are not expected to be released until December.

Results were strong in the second quarter, even as the market continues its slow rebound. Single Family Lending mortgage principal and Commercial lending mortgage principal both rose 15% from the prior year to $9.8 billion and $3.3 billion, respectively. The former category was boosted by higher renewal rates on the back of new mortgage rules and a tighter interest rate environment. Equitable

Group also reported a 24% increase in deposits to $12.4 billion with EQ Bank deposits climbing 51% year over year to $2 billion.

Home Capital stock was down 13.3% in 2018 as of close on September 27. Shares were up 7% year over year. Net income was reported at $29.6 billion compared to a net loss of $111.1 million in the prior year. Home Capital has revamped its internal underwriting policies, but originations have still taken a significant hit from its pre-crisis peak. It is unlikely the company will be able to recoup these losses in a tighter market, but it has the potential to benefit from the current stability going forward. Home Capital also reported strong renewal and retention rates in the quarter.

Alternative lenders are not going to be able to achieve the kind of growth investors saw at the peak of the housing boom. Equitable Group remains my top pick today, but Home Capital has put together several positive quarters and its price is enticing in the fall.

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aocallaghan