Money Matters

RSP's are a sound investment

By BRIAN SLESSOR

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Dollars and Sense

Like most Canadians, you probably realize just how valuable your Retirement Savings Plan is for sheltering income from tax and for helping you accumulate a significant amount of savings for retirement. But, as many others do, you may also find yourself faced with that frustrating conflict of making regular contributions to your RSP, while at the same time, you continue to pay interest (often at rates much higher than what your RSP assets can earn) on funds you've borrowed to pay for your home.

Many investors wonder whether it would be more practical to liquidate an RSP outright, or simply stop making annual RSP contributions until all outstanding debt is paid off. But the reality is, that by liquidating a portion or all of your RSP, you would lose a significant amount of your savings to tax. Furthermore the benefits of the annual tax savings on your RSP contribution and the ongoing tax savings of sheltered income can often outweigh the cost of interest payments.

Since 1984, the federal government has allowed certain mortgages to be held as an investment within a self-directed RSP, much in the same way as your RSP can hold Guaranteed Investment Certificates, Treasury Bills or stocks. Provided that you have sufficient assets to make the program cost-effective, and that your mortgage qualifies under the guidelines of the program, you can hold the mortgage on your own principal residence in your RSP and withdraw the offsetting funds. This way, your mortgage is held as an asset within your RSP so there are no tax consequences involved in making the transfer. This means that you can utilize your hard-earned RSP savings to either pay down your mortgage or for other purposes, without jeopardizing your goals for retirement.

There are several advantages to setting up this type of program. First, you will be paying the interest on your mortgage to your own RSP rather than to a mortgage lender. And because lenders normally earn a 'spread' on mortgage loans (the difference between deposit and lending rates), and your mortgage must be based on going rates your RSP is able to earn a better rate of return than what is available with most other fixed-income investments.

Second, because interest and principal payments flow back into your plan monthly, just as if you were making regular mortgage payments, they are able to compound more rapidly and provide you with more frequent reinvestment opportunities. Plus, the face that you now have a mortgage in your RSP does not affect your ability to contribute to your RSP in any way, so your annual contributions will continue to add to the overall value of your RSP. As these payments and contributions accumulate in your RSP, you will be able to reinvest these funds in any of the RSP-eligible investments that are normally available in a self-directed RSP.

Third, your mortgage is a top quality investment for your RSP - a first or second mortgage secured by your own personal property. This means you have the additional comfort of knowing the true market value of your investment first hand. Furthermore, because all mortgages held within RSPs must be insured, your retirement savings are protected against any possible default.

Finally, there are no restrictions as to how you use the funds borrowed through your mortgage. Although many people want to use the funds to pay down an existing mortgage or to finance a new home purchase, you may use these funds for any purpose you desire. If you use the funds for investment purposes, you may find that financing with a mortgage loan is less expensive than with a general investment loan, and best of all, the interest portion of the mortgage payments may be tax-deductible.

There are several conditions which must be met before you can use your mortgage as an RSP investment. One of these is that only non-arm's length mortgages - where you have an interest in the property - are eligible. Another is that the mortgage interest rates and terms must be in line with those available in the general market. Also, there are numerous costs involved in setting up and administering a mortgage RSP and these must be taken into consideration when studying the feasibility of the program, otherwise you could find that the fees consume any benefits you might have enjoyed from setting up the program. A rule of thumb is that you should have at least $40,000 in your RSP to make the program worthwhile.

This RSP strategy should only be considered after a thorough consultation with your Investment Executive.

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