

The Mortgage RSP

Did you know that you could hold your own mortgage in your *National Bank Financial RSP*? The self-directed aspect of our retirement savings plan allows you to consider your own mortgage as an investment just as you would a bond, stock, mutual fund or treasury bill.

By investing your plan's assets in your own mortgage, monthly mortgage payments are made to your *National Bank Financial RSP* rather than to another financial institution. The interest portion of each blended payment represents your return on the invested capital, while the balance is a partial return of this capital. Holding your mortgage as a security in your RSP is really no different from investing the plan's assets in other debt securities, except that you are both borrower and lender. More precisely, you are the borrower, and your Retirement Savings Plan is the lender.

For Whom?

The Mortgage RSP addresses:

1. Homeowners who want to replace an existing mortgage with one which they repay to themselves;
2. Home buyers who require a first or second mortgage;
3. Homeowners who want to renovate their homes;
4. Homeowners who want to make an equity withdrawal (i.e., to mortgage a property that is fully paid)

Conditions of the loan

The Mortgage RSP is subject to a fairly strict set of rules and regulations designed to protect your plan's assets. These rules are either established in the *Income Tax Act*, by the mortgage loan insurer *Canada Mortgage and Housing Corporation* (CMHC) or *GE Capital*, or by the administrator of your mortgage, herein represented by the National Bank of Canada.

1. Type of property:

Only owner-occupied properties (RSP annuitant) located in Canada, insurable by the CMHC and GE Capital meeting the administrators' requirements are eligible. These generally include single family dwellings, duplexes, triplexes and condominium buildings located in major urban centres. Seasonal secondary residences are not eligible.

2. Terms and conditions: prevalent on the market

The rate, terms and amortization of the mortgage loan must correspond to market conditions at the time the loan is contracted. The loan can be a first or a second mortgage, although if it is a second mortgage, the first mortgage must be with the same loan administrator.

Please note that the mortgage insurer will not insure a second mortgage when the loan would be used to finance a multiple-dwelling building.

When a loan is approved to renovate a property, the loan will only be disbursed once you submit the receipts attesting that the renovations have been completed.

Note that being your own mortgage lender does not enable you to default on your mortgage payments as this could give rise to negative tax consequences.

3. Loan administration:

The loan must be administered by a lender certified under the *National Housing Act*. In the case of *National Bank Financial's* Mortgage RSP, the mortgage administrator is the *National Bank of Canada* acting as representative of your plan's trustee, i.e., *Natcan Trust Company*.

4. Mortgage insurance:¹

As required by the *Income Tax Act*, the mortgage held by your RSP will have to be insured.

The mortgage insurer can issue such an insurance contract if the loan meets its requirements.

The table to the right gives the insurance premiums currently in effect as a percentage of the loan value in accordance with the ratio of the mortgage value to the property value.

Insurance Premiums*	
Loan to value ratio	Standard Premiums
Up to 65%	0.50%
66 to 75%	0.65%
76 to 80%	1.00%
81 to 85%	1.75%
86 to 90%	2.00%
91 to 95%	3.25%

* Assuming first mortgage paid out in one lump sum.

5. Amount:

The minimum loan for our Mortgage RSP is \$30,000. There is no absolute upper limit other than that imposed by the availability of funds in your RSP and by a credit risk evaluation done by the insurer and the loan administrator. The usual loan/value ratios apply: for an owner-occupied single family dwelling located in a major urban centre, the maximum loan is 95% of the value of the property for an initial purchase, and 75% for a refinancing.¹

Note that you may use the equity in both your and your spouse's RSP accounts to have a larger Mortgage RSP, should this be advantageous. In this case, mortgage payments would be credited to each account on a pro-rata basis according to participation, and the mortgage contract would be registered in the name of both your RSPs.

6. Term:

1 to 5 years, 7 years or 10 years.

7. Amortization period:

Up to 25 years.

8. Payments:

Blended principal and interest payments must be made monthly.

¹ The rules of the mortgage insurer in this regard are subject to change. The administrator of your loan will provide more details when you are ready to submit your request for a mortgage.

What does it cost?

A Mortgage RSP entails relatively high costs which must be taken into account when considering the viability of this investment. These fees can be paid either by the RSP or outside the plan with the exception of fees payable to your lawyer or notary which must be paid directly by you and must be added to those listed on your right (you may factor in an expenditure of approximately \$750.00 for this purpose). If you pay the fees inside the plan, you are paying with before-tax dollars. However, by doing so you are reducing the amount of capital you have sheltered from taxation. Note that with the exception of the annual RSP administration fee, all fees described to the right are remitted in their entirety to the loan administrator. As such, we have no control over these fees, and they may change at any time.

The costs involved – One time outlays	
Mortgage set-up fee (non-refundable)	\$300
Underwriting fee/loan insurer ⁽¹⁾	\$235
Appraisal fee	appr. \$500
Mortgage insurance ⁽²⁾	0.5% - 3.25% of mortgage
Recurring outlays	
Annual RSP administration fee ⁽³⁾	\$120
Annual mortgage management fee ^{(3) (4)}	\$250
Mortgage renewal/renegociation fee	\$100
Returned payments	\$25
(1) Subject to change at anytime without notice. (2) Subject to a 9% tax charged by CMHC; Natcan Trust must collect it. Premiums calculated according to preceding scale as % of amount of mortgage. (3) The GST and, if applicable, the PST must be added to these amounts. (4) If two RSP accounts are used to establish the mortgage, each account will be billed the annual mortgage management fee	

Comparative analysis:

In order to evaluate the potential benefits of the mortgage RSP, you must fully grasp the concept and understand the opportunity costs involved.

What the monthly payments are made of: By investing the plan's assets in your mortgage, you will be making substantial payments into your RSP each year. The total mortgage payments made to the plan over one year may seem large compared to the annual interest payments from a bond or term deposit investment. But you must not forget that mortgage payments are blended payments which include a partial reimbursement of capital. With an investment in bonds or GICs, all of your capital is reimbursed at maturity.

The investment which will be the most profitable one: Your decision to proceed or not with a mortgage RSP must be based on the differential in return, or spread between the mortgage rate and what your RSP could be earning if invested otherwise. In Canada, interest on mortgages is most often calculated semi-annually, so the mortgage rate can be compared directly with the return quoted for many other negotiable debt-based instruments such as Government of Canada, or provincial and municipal bonds (note that rates on term deposits are frequently quoted on the basis of annual payments).

The fees involved in setting up a mortgage RSP are considerable, so the differential between the mortgage you are considering and your current return must be substantial for the operation to be worthwhile.

The figures presented on the following page allow us to arrive at the following conclusions:

- with a \$30,000 mortgage, recurring expenses exceed 1% of the mortgage's initial value, so that the potential benefit of this proposition is marginal or non-existent when all the costs are taken into account;
- with a \$100,000 mortgage, this percentage is divided by a factor of 3 1/3%, so it can then be considered;
- please note, however, that the ratio of recurring expenses over the mortgage balance will steadily increase over the years as the mortgage balance is drawn down;

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- one time outlays incurred to set up the mortgage RSP range from 1.19% to 2.28% of the mortgage's initial balance depending on the size of the mortgage and the administrator of your plan. If this amount is amortized over 5 years only, these fees are equivalent to annual expenses of 0.24% to 0.46% of the mortgage's initial balance.

If, on the other hand, they are amortized over 10 years or more, they are then equivalent to annual expenses of 0.16% or less when the mortgage is for \$50,000 or more.

Another important aspect to consider with regards to the size of a Mortgage RSP is your ability to re-invest your monthly payments promptly so as to maximize your plan's return. Ideally, the monthly mortgage payments should be large enough so that they can each be reinvested immediately upon payment. If your monthly payment is only \$250, you will probably have to let three or four payments accumulate before you can re-invest this money, which lowers the overall return of your RSP.

The mortgage RSP can generally be an attractive investment for those people with large conventional term deposit RSPs which are exclusively invested in interest-bearing securities. If you are now investing your RSP's assets using a balanced portfolio approach, your long term return will probably be equal or superior to prevailing mortgage rates, and a mortgage RSP would be a losing proposition.

How the costs of the Mortgage RSP influence its return			
	Mortgage of		
	\$30,000	\$50,000	\$100,000
Recurring expenses			
RSP administration fee	\$120	\$120	\$120
Mortgage administration	\$250	\$250	\$250
\$100 renewal (amortized over 5 years)	\$20	\$20	\$20
Total	\$390	\$390	\$390
As a % of mortgage loan's initial value	1.30%	0.78%	0.39%
One time outlays			
Mortgage set-up fee	\$300	\$300	\$300
Underwriting fee/loan insurer	\$235	\$235	\$235
Mortgage insurance (\$150,000 property) (0.5% – 0.65%)	\$150	\$250	\$650
Total	\$685	\$785	\$1,185
As a % of mortgage loan's initial value	2.28%	1.57%	1.19%
Amortized over 5 years	0.46%	0.31%	0.24%
Amortized over 10 years	0.23%	0.16%	0.12%
Amortized over 15 years	0.15%	0.10%	0.08%
Amortized over 20 years	0.11%	0.08%	0.06%
Amortized over 25 years	0.09%	0.06%	0.05%

The table overleaf show how these factors work and are based on interest rates in effect on August 3, 2000, which reflect a substantial widening of the spread between mortgage and GIC rates over the last few years :

- the first example shows that with an initial mortgage balance of \$100,000, a mortgage RSP can be profitable over 5 years;

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- the second example on the other hand, shows that with an initial mortgage balance of \$30,000, the higher interest income produced by the mortgage over an equivalent amount GIC barely offset the important direct costs incurred to set up the mortgage RSP.

Comparison between 5-year compound GIC (yield 6.20%) and Mortgage RSP ⁽¹⁾																																																												
Example 1 – \$100,000 Mortgage																																																												
Number of years (A)	Interest on GIC (B)	Mortgage (note 2)			Interest on reinvested cash flows (F) (note 3)	Total interest (G) = (E + F)	Gross benefit (H) = (G – B)	Less direct costs (I) (notes 4 & 5)	Net benefit (J) = (H – I) (note 6)																																																			
		Payments (C)	Capital repaid (D)	Interest (E) = (C – D)																																																								
1	\$6,200.00	\$9,224.91	\$1,318.73	\$7,906.18	\$199.15	\$8,105.33																																																						
2	\$6,584.40	\$9,224.91	\$1,427.53	\$7,797.38	\$646.79	\$8,444.17																																																						
3	\$6,992.63	\$9,224.91	\$1,545.30	\$7,679.61	\$1,115.70	\$8,795.31																																																						
4	\$7,426.18	\$9,224.91	\$1,672.79	\$7,552.12	\$1,606.88	\$9,159.00																																																						
5	\$7,886.60	\$9,224.91	\$1,810.79	\$7,414.12	\$2,121.39	\$9,535.51																																																						
Total	\$35,089.81	\$46,124.55	\$7,775.14	\$38,349.41	\$5,689.91	\$44,039.32	\$8,949.51	(\$2,435.00)	\$6 514.51																																																			
Example 2 – \$30,000 Mortgage																																																												
1	\$1,860.00	\$2,767.47	\$395.62	\$2,371.85	\$59.75	\$2,431.60																																																						
2	\$1,975.32	\$2,767.47	\$428.26	\$2,339.21	\$194.04	\$2,533.25																																																						
3	\$2,097.79	\$2,767.47	\$463.59	\$2,303.88	\$334.71	\$2,638.59																																																						
4	\$2,227.85	\$2,767.47	\$501.84	\$2,265.63	\$482.06	\$2,747.69																																																						
5	\$2,365.98	\$2,767.47	\$543.24	\$2,224.23	\$636.42	\$2,860.65																																																						
Total	\$10,526.94	\$13,837.35	\$2,332.55	\$11,504.80	\$1,706.98	\$13,211.78	\$2,684.84	(\$1,935.00)	\$749.84																																																			
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(6) After the initial term of 5 years, the mortgage is paid back.																																																												

How to proceed

Provisions must be made to free up sufficient cash in the RSP before the funds are required for the mortgage. If you have not already done so, set up a *National Bank Financial Portfolio RSP* and transfer into it the funds and/or securities which you have accumulated in other retirement savings plans. Through your Investment Advisor, you then file a mortgage loan application.

The *National Bank of Canada* will:

- analyse your mortgage loan application;

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- submit your application to the mortgage insurer to obtain insurance on your mortgage;
- administer the loan on behalf of your RSP once all the requirements of disbursement are satisfied;

You will have to include a cheque payable to the *National Bank of Canada* with your application; this cheque will cover the set-up fee, the underwriting fee and the appraisal fee. All of the documentation required for a regular mortgage loan, such as proof of employment and a photocopy of a recent tax return or year-end pay stub giving proof of salary, must also be provided at this time.

The loan administrator will then proceed with an evaluation of your property, and a credit risk evaluation. At this point you will have to pay the mortgage insurance fees. Once all these formalities have been completed, the loan will be approved and it will then be up to your notary or lawyer to prepare the documents. Finally, the funds will be advanced by your *National Bank Financial* RSP to the loan administrator, who will remit such sums to your lawyer or notary for the closing. On average, this whole procedure takes approximately one month.

If your property was already mortgaged, you will use your RSP funds to reimburse the initial lender. If you want to finance the acquisition of a new home with your RSP funds, the funds will be used to pay the purchase price. In all cases, a new mortgage will be registered with your RSP as the beneficiary.

Your monthly mortgage payments are made by electronic transfers directly from your bank account to the loan administrator, who remits these amounts to us for deposit in your RSP. You can either consult with your *National Bank Financial* Investment Advisor each month, or issue standing instructions for re-investing these amounts.

An important decision:

Setting up a mortgage RSP is a complex process involving many participants. Your *National Bank Financial* Investment Advisor can help you determine whether a mortgage RSP is an attractive option for you, given your investment objectives and your personal financial situation.

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MANAGING
THE WORLD'S
MOST IMPORTANT
INVESTMENTS:

YOURS!

