The Money Manager

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*** Investments – Insurance – Mortgages ***

"Helping to make your dreams come true"

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In this newsletter I will be covering RRSP loans, protecting your retirement savings through investing with insurance products, RESPs, and mortgage interest rates. Please feel free to send me your comments and questions. Also let me know if there is something you'd like to see in future newsletters.

Does an RRSP Loan make sense?

Each year people scramble to make their RRSP contributions. For many people who find they don't have the money to make an RRSP contribution, they just don't bother. But does it make sense to borrow, to top-up your RRSP contributions. The money borrowed is NOT tax deductible.

The key to successful use of RRSP borrowing is to ensure you pay off the loan within a year.

Let's look at the numbers. Say you have $5,000 of unused RRSP contribution room and have a marginal tax rate (MTR) of 40%.

Scenario 1: Borrow $5,000 at 5% interest so you can invest immediately.

- You get a tax refund of $2,000 immediately, which you use to pay down the loan.
- This leaves you with a $3,000 loan to be repaid. Which is about $262.50 per month, including interest.
- If you are very conservative and had invested the amount in a 3% GIC, by the end of the year you would have $5150 in your RRSP.

Scenario 2: Don't borrow, but instead just deposit $262.50 each month for the year.

- Again, being a very conservative investor, the money goes into a high interest RRSP account that pays 3%.
- By the end of the year you will have $3193.68 in your RRSP account.
- The following year, you get $1277.47 back as a tax refund which you deposit into your RRSP. You will have $4471.15 in your RRSP.

So by borrowing to top up your RRSP, you gain an additional **$678.85**

If you were to retire in 25 years, borrowing will give you $10,783, while just saving will only give you $9,362.

The numbers are more dramatic for larger amounts, higher MTR, and higher investment returns.

So if you want to earn more in you RRSP and/or need help being disciplined in saving for your retirement, borrowing to top-up your RRSP may be the way to go.

Unhappy with your current financial situation? Need a second opinion on your financial strategy?

Book an appointment with me for a free no obligation assessment of your current investments, insurance & mortgage needs.

RESP vs TFSA

Debating of whether or not to invest in an RESP or the new TFSA?

If you are pretty sure at least one of your kids will be going to post-secondary school, and you don't believe you need to dip into the kid's education fund to make ends meet, then consider putting your money into an RESP rather than the TFSA.

Here are how the numbers play out between a RESP account versus saving money in a TFSA account.
The numbers assume the following: you are in the higher tax bracket so you only get 20% government grant, only deposit $2,500 per year at the beginning of each year & take full advantage of the government grant and receiving the grant money shortly after depositing your money, save for 15 years, and you've invested the money in a conservative income fund that returns only 3% annually.

- Your TFSA deposit of $37,500 has grown to $47,892 giving you an increase of 27.7%
- Your RESP deposit of $37,500 has grown to $57,161 giving you an increase of **52.4%**

Of course your child will have to pay income tax from their RESP withdrawal, but the tax should be nominal.

Also, RESP providers are not all equal. There are 2 main groups of RESP providers. The RESP scholarship companies, and everyone else. You will find that the RESP scholarship companies such as Heritage Scholarship & Canadian Scholarship have much more rules and fees in their plans. It is with these type of RESP plans that most people run into problems with because they don't know all the rules and fees. They are great so long as you follow their program and are okay with someone else determining where your investment goes.
If you want more flexibility, and more control of your RESP, then choose something not from the RESP scholarship companies.

Protecting your Investments

Since the market crashed, there have been horror stories about people not being able to retire because their investments lost more than 50% of their value. Even people who have relatively conservative portfolios have lost some value.
If you want to be a little more cautious and help protect yourself from future market crashes and still participate in the benefits of market gains, you may want to consider adding insurance products to your investment portfolio.

Three products from Transamerica Life you may want to consider are **Segregated Funds**, **Five for Life**, and **Universal Life Insurance**.

Segregated funds are similar to regular mutual funds but the major downside to them is that the MERs are usually higher than the equivalent mutual fund by around 1% or more.
However, being an insurance product they have some distinct benefits. One of the benefits is a deposit maturity guarantee. You can choose to protect 75% or 100% of your initial investment. Deposits mature every 10 years. If after 10 years the market crashes and your underlying mutual fund is down, your segregated fund can still return to you at least your initial investment. Segregated funds can also flow through capital losses to you, unlike mutual funds which can't.
Segregated funds are also RRSP eligible.

Transamerica's Five For Life product guarantees the owner 5% of their guaranteed withdrawal base. For the first 15 years Transamerica credits a 5% bonus on your deposit(s) for each year of no withdrawals. To lock in future increases there are also resets every 3 years based on the underlying investment you have chosen. This locked in amount will be your guaranteed withdrawal base. It is important to note that the bonus increases on your investment are purely "notional", and has no cash value. What this means is that if, after year 1, you pull out your investment, all you get is the market value of your initial investment. Not the market value plus the 5% bonus amount. You will receive all the increases at the time you reach age 65, which is the earliest you can start receiving the 5% payments. If you defer the 5% payments until age 75, you will get 5.5% for life.
During bad market times, if your underlying investments drops, the lowest your investment value will be is to the last reset amount or to your initial deposit(s), whichever is higher.
5% may not seem a lot, but say you deposit $100,000 when you are 50 years old. Even if your investment has zero growth except for receiving the annual 5% bonus, by the time you are age 65, you will receive at a minimum $8750 per year, which is really 8.75% of your original investment. This is similar to a defined benefit pension plan.
Five for Life is also RRSP eligible.

There is much debate on whether people should put their money into **Universal Life Insurance**, or just buy Term Insurance which is cheaper & invest the money you saved into regular mutual funds. In the earlier days of universal life insurance, your options were limited. However, investors have demanded better universal life products and the insurance companies have tried to accommodate.
The biggest complaint on UL as an investment vehicle is that the associated fees are higher than investing in regular mutual funds. At Transamerica Life, they offer 3 types of UL products. The WealthAdvantage and EstateAdvantage products offer increasing bonuses which helps to mitigate the higher UL investment fees, and there is a low fee version of the EstateAdvantage which has no bonuses but the lower UL investment fees makes it comparable to investing in regular mutual funds. Key thing to note here is that you are not investing in mutual funds directly. Rather, the underlying UL investment works like market-linked GICs. The annual interest rate is dependent on what you have designated as your investment vehicle. You can go with fixed GIC rates, interest rates tied to a market index, or interest rates tied to a specific mutual fund performance. If in a bad market year, such as now, the underlying mutual fund you are linked to drops, your current investment value does not decrease at all. During good market years, if the underlying mutual fund has a good return, you will receive an interest rate corresponding to that good return on your investment. So your UL investment never decreases. UL investments are also tax efficient as your investment can grow Tax deferred; and you can get Tax free retirement income through collateral assignment of the policy, unlike getting retirement income from a RRSP which is fully taxable.

Interest Rates & Mortgages

Interest rates are at it's lowest in decades with the Bank of Canada rate at 1%. Yet the consumer is not getting a better deal. Why is that? That's because the cost of borrowing your money is still higher. Interest dropped pretty fast and far. So many financial institutions are still committed to providing investment returns to you of 3 to 5%. If they want to make money, they have to keep the lending rates high enough to meet those commitments. Also being that the state of the economy is bad, the banks need to ensure they have sufficient cash to stay liquid, in case there are a high number of loan defaults. It is for this reason that the banks cannot give you the spread of 1 to 2% they use to between the Bank of Canada rate and the consumer lending rate.

That said, some lenders are providing pretty decent mortgage rates for these troubling times.
At time of publishing, the best fixed rate is a **3.75% fixed** closed mortgage for 3 years. For variable rates, the best rate is **Prime+0.75%** closed for 5 years.

If you are stuck with a high mortgage rate, it may be cost effective to break out of your current mortgage and get a new one. With open mortgages, that is no problem. With closed mortgages, you usually pay a penalty. The standard penalty is either 3 months of interest payments, or a interest rate differential calculation, which ever is higher.
Rate differential penalty is calculated as ***Remaining Mortgage Amount X (Mortgage Interest Percentage – Bank's Current Mortgage Interest Percentage) / 12 X Remaining Months***. Be sure to confirm the penalty with your lender before breaking the mortgage. You don't want any surprises.

As a comparison on how much you can potentially save by breaking out of a high rate mortgage, on a $200K mortgage & 25 year amortization-

- Interest payment for a 5% mortgage over 3 years = $28,770.41
- Interest payment at 3.75% mortgage over 3 years = $21,506.62

A savings of **$7,263.79**

Also, if you maintain the same payment level, you can shorten the amortization time, thus saving additional thousands of dollars.

Tired of your current job? Or looking for a great part-time business?

Consider joining with me to become an financial advisor with World Financial Group.

No experience necessary as you will be trained in the business.

You just need a strong desire to help others and improve your own financial situation.