

# RRSP MORTGAGES



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A Report by Madan Real Estate Solutions

Madan Real Estate presents a summary of RRSP Mortgages. Select terms are defined, common questions are answered and a step-by-step guide is presented with contacts to help you get started.

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## AN INTRODUCTION TO RRSP MORTGAGES

Not happy with your *Registered Retirement Savings Plan* (RRSP) investment returns?

Consider using your self-directed RRSP portfolio to invest in private mortgages backed by Canadian real estate. With a self-directed mortgage, the RRSP becomes the mortgage holder. Each monthly payment is a fixed income payment that goes directly back to your RRSP account **tax-free**. This creates a regular source of funds for you to re-invest, without taking your savings out.

A trustee approved under the *National Housing Act* must administer an RRSP mortgage, some trustees include:

- Toronto Dominion Bank
- B2B Trust
- Olympia Trust
- Canadian West Trust

### Can only RRSPs be invested in mortgages?

No, the same principles apply to: Registered Retirement Income Funds (RRIFs) and Locked in Retirement Accounts (LIRAs).

### Must the entire mortgage fund be provided by one plan?

No, mortgages can be funded wholly or in part from the annuitant's RRSP. Thus, if your RRSP was not large enough to fund the entire mortgage, the mortgage could be split between you and other RRSP funds holders.

### Does only residential real estate apply?

No, you can lend on single-family homes, multi-family properties and commercial real estate.

#### According to CRA...

**"A mortgage, or an interest therein, in respect of real property situated in Canada is a qualified investment for a plan trust. There is no requirement that the mortgage be a first mortgage or a residential mortgage"**

## What does CRA have to say about RRSP Mortgages?

The Canadian Revenue Agency (CRA) allows a wide range of investments to be held within registered retirement accounts. Most people are familiar with holding stocks or mutual funds, but few realize that investments may also include:

- ✓ Bonds and Debentures
- ✓ Term deposits and Guaranteed Income Certificates (GICs)
- ✓ Equity linked notes
- ✓ Rights and warrants
- ✓ Covered calls, long calls and puts, and LEAPS
- ✓ Gold and silver certificates
- ✓ And **mortgages secured by real property**

See: Income Tax Interpretation Bulletin No: IT-320R3 found on [www.cra-arc.gc.ca](http://www.cra-arc.gc.ca).

## ARM'S LENGTH VS. NON-ARM'S LENGTH MORTGAGE

The term **arm's length** is used by CRA to refer to how closely or distant the borrower/property owner and the lender are in relation to each other. The CRA regulations permit both arm's length and non-arm's length mortgages as qualified investments in an RRSP, however the rules differ between the two.

Arm's Length Mortgage	Non-Arm's Length Mortgage
A mortgage that allows RRSP annuitants to use the money from their self-directed RRSP to fund a mortgage to a third party not related to them by blood, marriage or adoption. There is no requirement to have this mortgage insured, and the terms and rates have greater flexibility.  <i>Example:</i> Friends, Strangers, Uncles, Cousins	A mortgage where the mortgagor (i.e. the borrower who is mortgaging his or her property) is, in fact, the annuitant. In order for a non-arm's length mortgage to qualify as a valid investment within the self-directed RRSP, the mortgage must be insured, and the interest rate and terms must reflect normal commercial practice.  <i>Example:</i> Brother, Parents, Spouse, Children

**\*\*\*\* Please Note that as of April 17<sup>th</sup>, 2012, TD Bank will no longer offer Arm's Length Mortgages.**

For more information regarding CRA's definition of arm's length and non-arm's length, visit: <http://www.cra-arc.gc.ca/E/pub/tp/it419r2/it419r2-e.html>.

## What happens if the borrower is in default?

If the annuitant is unable to make his or her monthly mortgage payments, the financial institution administering the mortgage will place the mortgage in default. It will then attempt to collect the proceeds upon a power of sale of the property.

## Can the borrower be a corporation?

Yes, you can lend to a corporation, however you cannot have “controlling interest” in the company. Ask your lawyer about non-controlling shares. See CRA’s definition of controlling interest.

## Can the borrower deduct the interest paid?

If the proceeds from the mortgage are being used on an investment property, the cost to set up the mortgage as well as the mortgage interest may be considered tax-deductible expenses. CRA requires a clear audit trail of the investment and the mortgage.

## FIRST MORTGAGE VS. SECOND MORTGAGE

A mortgage is a loan secured by a property, where the loan is registered on the title of the property.

A **first mortgage** is the standard mortgage you received from the bank when you buy your home. If you default on your mortgage payments, the bank will try to collect the debt via power-of-sale (Ontario).

A **second mortgage** is a mortgage in second position, meaning that the mortgagee is next in line on the property after the bank (the first mortgage holder) in case of default. The mortgage is secured by registering it on the title, thus the owner cannot sell the property without paying back the mortgage. A second mortgage is more risky than a first mortgage; therefore the interest payments are usually higher than a first mortgage.

**For example: A property costs \$300,000. Available financing is a mortgage loan covering 80% of value, or \$240,000. The required cash down payment is \$60,000. A second mortgage is available from a private individual for an additional \$30,000 of value, reducing the down payment to \$30,000. As long as the cash flow from the property can support the second mortgage payments, this is smart real estate investing.**

## WHY SHOULD YOU INVEST IN MORTGAGES?

- Mortgage interest payment is a **fixed income** payment; it is consistent, paid every month.
- Investing in mortgages is often **less risky** than mutual funds and stocks, because you are secure in both the borrower and the property.
- The lender has **control** over choosing the property and the borrower to invest in.
- The lender has **the freedom** to negotiate the interest rates and terms with the borrower.
- An opportunity to invest in real estate **without becoming the landlord** and running after tenants.
- Earn **passive income** while staying tax-sheltered.
- No time and no real estate expertise is required.

### Does this just work with RRSP money, or can I use cash to invest in Mortgages?

You can absolutely use cash to invest in mortgages, or you could learn how to invest in real estate yourself, or if you prefer a hands-off approach, invest with a partner via Joint Ventures.

### What if I do not have enough money to hold a mortgage?

It is common to put together a number of investors who have never met into a group to fund a mortgage. Each investor is individually registered on title for the % of the mortgage they hold.

## RRSP MORTGAGE FEES

Fees involved in a RRSP mortgage transaction vary between the trustees.

Fixed Fees		Ongoing Fees	
▪ one-time mortgage set-up fee	\$50 - \$250	▪ annual self-directed RRSP fee	\$100-\$135
▪ lawyer's and disbursement fees - depends on the lawyer		▪ annual mortgage admin. fees	\$100-\$225
▪ in case of a non-arm's length mortgage, mortgage insurance premium	.... 0.05-2.0%		

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## A STEP-BY-STEP GUIDE

- 1) Go to a Canadian Trust company and open a self-administered RRSP account. There is a list of contacts below to help you locate the representative nearest you.
- 2) Transfer your RRSP or RRIF or LIRA funds to your self-administered account.
- 3) Determine whom you are lending money to. Do your due diligence on the borrower and the property.
- 4) Determine the type of mortgage (is it a first or second mortgage?) and negotiate the terms, conditions and interest rate.
- 5) Take the mortgage commitment to a lawyer. If the funds are less than \$50K, one lawyer may represent both parties, otherwise, legally two lawyers have to be involved.
- 6) Complete and sign the mortgage commitment. The lawyer will register the mortgage on title.
- 7) Fill out and sign an Arm's Length Mortgage Package with your Trustee of choice.
- 8) Set up an automatic payment system with the borrower, and watch the monthly returns go into your account.

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### Can I do this across Canada?

No, Olympia Trust, B2B Trust, and Canadian Western Trust do not administer self-directed RRSP mortgages on properties located in the province of QUEBEC. A Quebec resident can however lend RRSP mortgages registered with B2B or Olympia, outside their province. CWT does not do business in Quebec.

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### How do I go about finding out where I can locate properties to place my RRSP monies to?

You can contact us to discuss opportunities that we may have available now.

## LIST OF TRUSTEES

### 1. Toronto Dominion Bank

- As of April 17<sup>th</sup>, 2012 only offers Non-Arm's Length Mortgages
- <http://www.tdwaterhouse.ca/products-services/investing/discount-brokerage/types-of-accounts/assd.jsp>
- 1-800-465-5463

### 2. B2B Trust

- Does not administer SDRRSP Mortgages on properties located in QUEBEC
- [https://b2btrust.com/en/iwant/self\\_directed\\_mortgages.html](https://b2btrust.com/en/iwant/self_directed_mortgages.html)
- 1 800 263 8349

### 3. Olympia Trust

- Does not administer SDRRSP Mortgages on properties located in QUEBEC
- <http://www.olympiatrust.com/plans/>
- 1-877-565-0001

### 4. Canadian Western Trust

- Does not do business in QUEBEC
- <http://www.cwt.ca/iris/individuals/default.htm>
- 1-800-663-1124

## Sources:

- "Self-directed Mortgages" a guide published by TD Waterhouse, Fall 2011
- B2B Trust, Olympia Trust, Canadian Western Trust
- Canadian Revenue Agency's website
- Paul Blacquiere, Spirepoint Real Estate
- This information has been discussed with our lawyer, accountant and mortgage broker.

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