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Jordan's & Elaine's New Strategies Bulletin

FHSA Issue

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A Better Way to Help Your Children Buy Their First Home or To Buy Your Own First Home

In the past, there were four sources of funds for a first-time homebuyer to gather a deposit to put down on their first home: save in a non-tax advantaged account (a bank account or unregistered investment account), save in a TFSA where growth on the savings is non-taxable, get a gift of funds from family, or borrow up to $35,000 from their own RRSP, with 15 years to repay their RRSP. The TFSA is obviously preferable to an unregistered, untax-advantaged savings account, but the amount that can be tax-sheltered in a TFSA is limited to how much contribution room a person has. And while it was nice to be able to put money into an RRSP to get the tax deferral before using the money to buy a home, it could be a challenge to pay back the RRSP on the government's schedule, while also making mortgage payments. But now there is a new and improved option.

Last year the federal government announced the First-time Homebuyers Savings Account (FHSA) which will be available soon. There are some serious advantages to using a FHSA to buy a first home and there are advantages to help children fund an FHSA, compared to just gifting them money, when they're trying to buy their first home. Let's look at the rules and features of an FHSA.

- Anyone who has not owned a home before and is at least 18 years old can open an FHSA.
- You can contribute $8,000 to the FHSA in the first year it's opened, and once the account is opened, you get $8,000 of contribution room/yr to allow contributions to a total of $40,000
- Contributions to an FHSA are tax deductible, so they reduce the account holder's taxes owing.
- You can take the money out of the FHSA tax-free when you buy your home.
- Money withdrawn never has to be repaid.
- **If a parent gifts money to a child** for the FHSA, there is no tax attribution on the earnings back to the parent, because the recipient child is over age 18, and the child gets the **added gift of a tax rebate**. So an $8,000 gift that goes into an FHSA might end up being worth more than $8,000, exclusive of earnings on the money. If the child doesn't have enough taxable income to make good use of the tax deduction, they can defer deducting the contribution against taxable income until a later, higher income year.
- Any earnings in the FHSA are not taxable – ever.
- **NEW (recently changed rule)** - a first-time home buyer can use both an FHSA and a HBP withdrawal from their RRSP.

- The plan can only remain open 15 years or until the plan owner turns 71.
- Money in the FHSA not used for a home purchase can be transferred into an RRSP or RRIF without using up any RRSP contribution room or causing taxation, but you don't get a second tax deduction on the same money, when it goes into the RRSP.
- You can also transfer from your RRSP into a FHSA, if you have contribution room. You don't get a second tax deduction there either, but you are relieved of the necessity to repay the money after you use it to buy a home, which means you got to withdraw funds from your RRSP permanently and tax free.

Maybe (probably) a child doesn't have $8,000 to put into an FHSA at least 5 years before buying a first home, it could still be advisable to open an FHSA, even with $500, to start accumulating contribution room to be used in the future. Remember it would start the clock on the 15 year time limit of having an FHSA open though.

There isn't much point making contributions to a Registered Education Savings Plan (RESP) past the year in which a child turns 17, because contributions can no longer receive government grant money. That could be a good time to divert any monthly RESP savings into gifts to the child to be put directly into an FHSA, but not claimed on the child's taxes until they are working full-time.

Because FHSAs are so new, we don't have more details than those above. In the new year, account opening forms should become available, and we will learn whether or not beneficiaries can be named and other details about FHSAs. If you are interested in opening such an account, please call us. We will then set up an appointment with you as soon as accounts can be opened (which likely won't be until April 2023, or later).

OTHER TIPS FOR A FIRST-TIME HOMEBUYER

Shop around for your mortgage. Most people start by getting a quote from their bank, and the bank may give a better rate to clients who also have a credit card with them or use other bank services. You can call a mortgage broker (or even more than one) or check for their best rates on their websites. Many people find they can get better rates through a broker who specializes in finding the best rates across many lenders. There are also sources not commonly quoted by mortgage brokers that you may hear advertised on the radio or even Manulife Bank, that you may wish to call to check for the most competitive rate. Getting a lower interest rate can save you a lot of money, so it's worth the effort.

Call us to discuss what the market expects interest rates to do, because that could influence the terms you want for your mortgage. For example, if rates are falling, you may want your mortgage term (the period you lock into a rate and payment for) to be short, so you can renew in a while at a lower rate, or you may want to do a variable rate mortgage where the rate will fall if interest rates do. If rates are rising, there are different strategies. If you are expecting a windfall soon, there are different mortgage strategies to use. We can help you think about options to discuss with your lender. We don't have a crystal ball and can't guarantee where rates are going, but we can certainly tell you what we're hearing economists expect.

Be prepared for approximately a 5% deposit when you put in your offer. That size deposit is often required within 24 hrs of making an offer on a house. You can't get money out of your Manulife accounts in less than 24 hrs, so make the sure money is in your bank account before you make an offer on a home.

If there is a chance that mortgage rates could rise before the closing date when you take possession of your house, then talk to a lender about "holding or locking in" the current rate for you for a while, even if interest rates go up. This could save you money on your mortgage payments.

If you have less than 20% of the price of your home saved, you may have to take CMHC insurance.

If you don't have enough money to put down 20% of the purchase price, then banks generally require you to pay for Canada Mortgage and Housing Corporation (CMHC) Insurance. This insurance protects the bank or other lender in case you default on making your mortgage payments. If you put very little down on the house (like 5% to less than 10% of the purchase price), then the insurance cost to get a mortgage could be 4% of the purchase price of your house. So, you could pay 5% of the cost of your house as a down payment, plus 4% of the cost, for a total of 9%, and still owe 95% of the cost. Obviously, it is very expensive to make such a small down payment (and if your house price goes down more than 5%, you could easily end up owing more than your house is worth, which could make renewing your mortgage problematic). If you put 20% down payment on the house, you don't need CMHC mortgage insurance. However, without that insurance the banks or other lenders are likely to charge you a higher rate of interest, because there is more risk to them of non-payment by you. So even if you've saved enough to put 20% on your house purchase, you may only want to pay 19.9%. Then you pay a tiny bit to get CMHC insurance, but you could get a better interest rate.

Many, many of our clients did not stay in their first house for 5 years. Those with 5 year terms on their mortgages ended up having to "break" their mortgage. This can involve paying thousands of dollars to the lender. When you choose a lender for your mortgage, the interest rate may not be the only consideration. You might want to inquire about the cost to terminate the mortgage early, about the pre-payment privileges (how much you can increase your payment by or how much you can pay off extra each year). Also inquire whether lawyers' and appraisal fees will be paid by the lender or you.

Sources: CMHC website https://www.cmhc-schl.gc.ca, an Advisor.ca Nov 23, 2022 article https://www.advisor.ca/tax/tax-news/first-time-homebuyers-can-use-fhsa-and-hbp-feds-propose/#:~:text=First%20proposed%20in%20the%202022,taxable%2C%20like%20with%20a%20TFSA. and a Nov 21, 2022 Investment Executive article https://www.investmentexecutive.com/brand-knowledge_/desjardins/first-home-savings-get-a-boost/.

We hope you found this information helpful. Call us if you have any questions or want to pursue opening a FHSA, when they become available in 2023, or if you just want to discuss interest rate expectations.

Elaine

Jordan

Elaine Royds, MBA, CFP®

Senior Financial Advisor,
Manulife Securities Incorporated
Financial Planner,

Jordan Royds, CFP®

Financial Advisor,
Manulife Securities Incorporated
Financial Planner,

Manulife Securities Insurance Inc. Manulife Securities Insurance Inc.

Suite 303 - 1685 Main St W, Hamilton, ON L8S 1G5
Office 905-393-0787 Toll Free 1-855-640-1857
Website www.roydsfinancial.com

Investment Advisor Assistant, Manulife Securities Incorporated: Sarah Breimer
Senior Administrative Assistant: Dharini Jani
Administrative Assistant: Pauline Marchong