Pro-Text
by Dan Reith

Borrowing to Invest

In today's culture, borrowing money is not only inevitable; often it is also an intelligent business decision. It makes sense as it allows us to buy the things we want, such things as a car, a house, pay for a child's education, take a vacation, or invest in our future. It is important to understand that all loans are not created equal. While the interest cost on most loans is fully paid by the borrower, the interest cost on an investment loan is generally tax-deductible – meaning that the government effectively subsidizes a loan that is used for investment purposes. This means, if you have an investment portfolio, a car loan and a mortgage, you're probably paying too much tax. Here is something to consider: If you are going to purchase a cottage for $50,000 and you already have a non-registered investment loan for $50,000, you can sell your non-registered investment loan to pay for the cottage then immediately take out a $50,000 loan to repurchase the investment. By choosing to pay $5000 of the loan each year for 10 years, plus interest, at an average interest rate of 7 percent, you will come out ahead because the loan interest is 100% tax-deductible. Converting non-deductible debt to deductible debt in this way can be a highly effective borrowing strategy.

It is important to understand how the "borrow to invest" strategy works so you can determine whether it is right for you. An investment loan is right for those who have maximized their RRSP contributions, and are looking to build non-registered assets. It is also beneficial to those who have a long-term investment horizon of at least 10 years, and have adequate disposable income to comfortably pay loan interest.

Another way to reduce the cost of borrowing is by reducing your mortgage interest rate. Let's assume you are a homeowner with a $250,000 home, and with $100,000 outstanding on your mortgage and you want to purchase a $50,000 cottage. With a flexible, variable-rate mortgage you are able to withdraw up to 75 percent of the value of your home at any time while paying the prime interest rate. If you took out a second mortgage on your home instead, you would pay a higher interest rate on your loan. Therefore, by paying back a lower interest rate over 10 years, you come out ahead.

With the advice of your financial advisor, borrowing money can be a very effective way to achieve your financial and lifestyle goals. By making use of effective borrowing strategies, you can reduce the cost of borrowing and focus more of your financial resources on creating wealth.

This column appears regularly in Business Beat and has been submitted by Dan Reith BA (Hons) CAIB, a principal of Reith and Associates Insurance and Financial Services, 462 Talbot Street, St. Thomas, and based on information provided by Encon Insurance Managers. Dan is also a Member of the Chamber's Board of Directors. Questions and comments on this column are welcomed by the writer and 631-3862 or via e-mail: info@reithandassociates.com