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Budget measures aimed at home buyers could put retirement savings at risk

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New incentives for home buyers introduced in this year's federal budget will be attractive to certain people, but financial advisors are already warning some clients to think carefully before they take the plunge.

Ottawa introduced provisions in the federal budget aimed particularly at helping millennials and couples seeking to buy their first home, but who face challenges coming up with sufficient funds for a down payment. These measures include an interest-free mortgage loan in exchange for shared equity ownership, as well as higher thresholds for interest-free borrowing from registered retired savings plans (RRSPs).

"These provisions may enable some people to get into homes that they might not otherwise be able to get into," says Michael Dorfman, portfolio manager and managing director with the Dorfman Group at BMO Nesbitt Burns Inc. in Toronto. "But the provisions are small and incremental for people trying to get into a market like Toronto, where prices are high. So, it's not a universal program."

For the shared equity provision introduced in the budget, the Canada Mortgage and Housing Corp. (CMHC) will become a mortgage provider in addition to its traditional role as a mortgage insurer. The CMHC will now offer interest-free loans worth up to 10 per cent of the price of newly built homes or 5 per cent for resale homes. In turn, the CMHC shares equity in the homes, meaning the loaned money must be paid back when the property is sold.

To qualify, first-time home buyers' combined annual household incomes must be less than $120,000 a year. There are also limits on the amount that can be borrowed; the most expensive home available under the program would be slightly less than $500,000.

Another provision in the budget is a boost to $35,000 from $25,000 in the amount first-time home buyers can borrow from their RRSPs for a down payment as part of the Home Buyers' Plan (HBP). Members of a couple can now each access that amount, conceivably coming up with $70,000 for a down payment. Furthermore, those who now experience the end of a marriage or a common-law relationship can now access the HBP

as well. The interest-free loan must be paid back within 15 years to avoid additional taxes.

But while these measures make it easier for some prospective home buyers to enter the housing market, they also need to take into consideration the fact that the down payment is only the start of the cost of home ownership.

“Home ownership is the ultimate dream for a lot of people,” says Kevin Dunphy, certified financial planner with the Dunphy Molly & Associates team at Investment Planning Counsel Inc. in St. John’s, Nfld. “But it’s not for everybody.”

People in the main target groups the budget proposals are designed to help don’t necessarily have bulky RRSPs from which they can borrow, Mr. Dunphy says. In addition, they also need to have the ability to pay for unexpected events.

“If you’re on that part of the spectrum where it’s tough keeping up pay cheque to pay cheque, where do you get the $15,000 or $20,000 to fix the roof?” Mr. Dunphy says.

Still, he expects that some of these clients will ask for details about the new home-ownership provisions introduced in the budget. “We’ll end up talking to our clients and asking them if home ownership is realistic for them,” Mr. Dunphy says.

Furthermore, while having greater access to more funds as part of the HBP will make it easier for some clients to access home ownership, it also poses long-term risks that clients should consider.

“I have always warned people that they have to be cautious about the Home Buyers’ Plan,” says Doug Carroll, practice lead for tax, estate and financial planning at Meridian Credit Union in Toronto.

“You’re raiding your retirement savings. People say, ‘Fair enough, but why can’t I use my money for a house now and [worry about my] retirement savings [later]?’ If you’re flush with cash and have expectations of future cash, maybe that’s not going to be a problem, but it can be an issue for people who don’t have all their planning in order,” he adds.

“People need to be conscious of all their cash flow – paying back the mortgage, paying utilities and upkeep and paying back the money into their RRSP if they use the Home Buyers’ Plan,” Mr. Carroll says. “This change in the budget to $35,000 from $25,000 doesn’t seem to change the payback period. If it’s a couple, they may need to pay back $70,000, and the danger that I have seen with clients is that the payback becomes too large to handle. The money to be paid back becomes taxable income in the year when the payback is due, and some people simply don’t have the money.”

On balance, the budget provisions for home buyers will help younger people get into home ownership, which is a good thing, says Mr. Dorfman. However, he believes these measures will appeal only to a narrow niche of the market. In addition, he says the

government could have taken measures to protect retirement savings and encourage savings in other vehicles.

"I would have thought other measures could have helped as well, such as increasing the amounts that can be contributed to tax-free savings accounts (TFSAs)," Mr. Dorfman says.

Mr. Dunphy agrees, noting that TFSAs are one of the most attractive vehicles for clients to save for big-ticket items such as down payments. "I'd like to see the government do more to encourage people to save."

Indeed, one strategy for first-time home buyers is to contribute the maximum amount to RRSPs each year to lower their income and reap a tax refund, which can then be invested into a TFSA that can be applied toward a down payment for a home.

Individuals can contribute up to $6,000 to their TFSAs in 2019, up from $5,500 in 2018; and those who didn't contribute in previous years can make up for lost time.

An individual who has been living in Canada since TFSAs launched in 2009 and was at least 18 years of age at that time can put in $63,500 and let it grow – potentially into a hefty down payment.

Unlike borrowing from an RRSP or sharing a mortgage with the CMHC, tax-free savings are clients' own money – and they won't have to pay it back.

"The new programs may be attractive, and the money they offer may be cheap," Mr. Dorfman says, "but it's still debt – and you have to manage debt."

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