TALES FROM THE TRENCHES™
BY BARRY C. MCGUIRE

RRSP MORTGAGES AND THE CRA.

Registered Retirement Savings Plan (RRSP) mortgages, the supposed Holy Grail of private lending. I hear it all the time. Borrowers of all stripes believe there is a vast pot of money held in RRSP accounts just waiting to be lent to them. And, to some extent, that's true. There are lots of folks with lots of RRSP money tucked away. Maybe you've thought about leveraging your RRSP to become a lender yourself.

But, like everything else run by the government, there are rules to follow if you want to lend your RRSP money as a mortgage.

According to the Canada Revenue Agency (CRA), mortgages, like stocks, bonds, and GICs, can be what's known as a 'qualified investment' for an RRSP. The operative words here are, "can be."

For an RRSP mortgage to be a qualified investment, it must be:

1. arm's length,
2. usually administered, and
3. commercially reasonable

In this post we are going to focus on the commercially reasonable side of things. If the CRA decides to audit your RRSP, will you be onside or offside their rules? So, let's chat about what makes a mortgage ***commercially reasonable***.

The best way to figure this out is to compare your loan against what happens out in the marketplace. How do bankers and commercial lenders underwrite their loans to figure out whether it is risky or not? If you're going to act as a lender, then you may as well take a page from the pros!

Lenders rely on valuations of the property.
The best way to figure out what a property is worth is to obtain an appraisal from a certified appraiser. Less esteemed valuation methods are to get a Certified Market Analysis (CMA) from a realtor or a current tax assessment.

Calculate the Loan-to-Value (LTV) ratio.
Banks and other mainline lenders are not allowed to offer more than 80% (this used to be 75%) of the value of the property without using National Housing Act (NHA) insurance, which is usually provided by Canada Mortgage and Housing Corporation (CMHC) or sometimes a private insurer. If you are proposing to lend more than 80% of the LTV without the mortgage being insured, is that commercially reasonable?

Interest rates are important.
Private lenders usually charge a higher rate of interest than banks. If your RRSP loan has a five-year term and your interest rate is less than mainline lenders, the CRA might not like that.

Interest rates should have a relationship to the LTV ratio.
Once the LTV ratio is over 80%, in the private marketplace, rates rise astronomically. Why? Because the most experienced lenders in Canada, the mainline lenders, understand that their risk of default and loss rises dramatically over the 80% mark. Therefore, private commercial lending rates range between 8%-20% for

loans where the LTV ratio exceeds 80%. The higher the LTV ratio, the higher the rate of interest. Private lenders need to be paid for their risk.

The lesson here is, be a careful lender. Even though I believe the risk of CRA audit is small, there is a risk. Prepare for that risk and more importantly for you, protect your hard-earned RRSP funds.

LESSONS LEARNED:

1. Be a commercially reasonable lender.
2. Do as much diligence on a borrower and property as a bank would do.
3. High LTV ratios make for risky loans. Your interest rate should reflect your risk.

FOR ALL YOUR ALBERTA REAL ESTATE LEGAL NEEDS, CONTACT BARRY MCGUIRE TODAY!
EMAIL B.MCGUIRE@RMLO.COM

RMLO Law LLP
Suite 101, 10301-109 ST Edmonton, AB T5J 1N4
Phone: 780.431.1444 Fax: 780.431.1499