



Using property's equity to invest can be risky

Approach favoured by large corporations, wealthy individuals not for faint of heart

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Ever hear of the Smith Manoeuvre? How about the Singleton Shuffle? No, they're not fancy dance steps; they are strategies devised by accountants to take advantage of low mortgage rates coupled with high investment returns.

In essence, they are a way to take equity out of a family home, invest it in the stock market, pay off that mortgage loan and take a hefty tax deduction, all at the same time. But do they make sense for the average homeowner? It depends on whom you ask.

"Absolutely not, unless you are a very sophisticated, very long-term investor," says Tracy Broeze, a financial planner with Cumming & Cumming Wealth Management in Oakville. "Unless you can make payments on the mortgage and have the patience to last through losses for those three years, moves like that can spell disaster."

David Phipps, a financial adviser with Assante Capital Management Ltd. in Ottawa, backs Broeze.

"This is precisely the wrong time to consider any of those moves," he says.

Peter Majthenyi, a mortgage planner with Mortgage Architects, argues the opposite case. "It is a great way to make the best use of mortgages," he says. "All you are doing is taking the same approach used by corporations and high-wealth individuals for years. It is my core business."

The Smith, Singleton and similar strategies argue that rising prices have left many people with great chunks of unused equity in their homes. Many are paying interest on mortgages in the 5.5 per cent range. At the same time, dividends from blue-chip shares are paying 7 per cent or more a year.

Stir in the fact that mortgage interest is not tax deductible, while loans taken out to purchase interest or dividend bearing investments are, and the double whammy of that spread between cost of money and investment returns plus an interest payment tax write-off can translate into significant money.

Majthenyi offers an example. A homeowner with a paid-up principal residence takes out \$200,000 in a first mortgage at 5.5 per cent interest and uses that money to invest in blue-chip stocks paying 7 per cent a year. The income from the dividends is then used to make mortgage payments. Because the loan was used for investment purposes, the interest is deductible against annual income, which in the highest marginal rates could mean annual savings of \$10,000.

The 1.5 per cent spread between the cost of the loan and dividend income could mean another \$3,000 gain. And as the price of those shares rise over time, the investor can also count on a gain on equity.

Phipps admit to being on the conservative side.

"It may not be a bad idea for some investors under certain conditions," Phipps says.

"But do you really want to play the stock market with borrowed money?"