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Fraser views house debt as positive

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Fraser Smith has written a bestselling book on personal finance by telling Canadians not to pay off their mortgages.

He wants people to convert bad debt (a mortgage) to good debt (an investment loan) by swapping one for the other.

By using something called a "readvanceable mortgage," you can get a tax deduction for the interest paid on a mortgage (which is generally not tax-deductible).

The strategy to convert a negative to a positive is called the Smith Manoeuvre.

Here's how it works: (1) Make your regular mortgage payments. (2) Borrow back the principal reduction that occurs as you make each payment. (3) Create an investment loan that is tax-deductible.

After the first year, you will get a big tax refund. Use this money to make an extra payment against your mortgage, then immediately borrow back and invest the same amount.

What's interesting about the Smith Manoeuvre is that you never reduce your debt. Borrow $250,000 to buy a house and pay off that loan over 25 years. Guess what? You still owe $250,000 at the end.

But now you have investments that are worth more than $250,000 – or so you hope. You can sell these investments to discharge the loan.

What about the time-honoured strategy of contributing to a registered retirement savings plan? Doesn't that offer a hefty tax saving?

In many cases, Smith says, you would do better to cash the RRSP, pay the tax and use the money to make a lump-sum reduction of the first mortgage. Then, you immediately borrow back that money and invest it outside the RRSP.

Only after converting all non-deductible mortgage debt to tax-deductible investment debt should you resume your RRSP contributions.

As you might expect, you won't hear much about RRSP alternatives from your friendly banker or investment dealer.

They're too busy asking you which mutual fund you want to buy before March 1, the deadline to invest in an RRSP and save taxes on your 2006 return.

Despite a lack of support from mainstream financial institutions, the Smith Manoeuvre has taken off through word-of-mouth and vigorous debate at online discussion forums.

"I've passed 30,000 books sold and I'm printing 10,000 more this week," he told me about his *The Smith Manoeuvre: Is Your Mortgage Tax-Deductible?*

These are amazing sales figures for a self-published book, not terribly user-friendly, that first came out in 2002. I picked up a copy of the seventh printing recently at a Costco warehouse store for $12.99 (half the cover price).

So, who is Fraser Smith? As a financial adviser in Vancouver, he came up with the idea in 1984 and pitched it to Canada's largest credit union.

The Vancity credit union attracted many new customers by working with them to make their mortgages tax-deductible and helped secure a dominant position in the B.C. market.

Smith, now retired and living in Victoria, has been working with partners to start a new company, Smith Manoeuvre Financial Corp. They opened an office last month on Bay St. in downtown Toronto and set up a website, www.smfc.com.

He has names and numbers of about 450 financial planners and mortgage brokers who can help put the plan into action.

"It's a great strategy, but it's not for everyone. You have to consider your risk tolerance," says Elisseos Iriotakis, a certified financial planner and vice-president of mortgages for Safebridge Financial Group in Toronto.

He finds clients are split. Half welcome the idea of swapping bad debt for good debt, while the other half worry about borrowing to invest and possibly losing money.

"It's not good for the average person. Most of my clients wouldn't understand it because it's very complex," says Gary Newby, a certified financial planner in Toronto.

Newby took a course on the Smith Manoeuvre, which explains why his name is on the list of advisers who endorse the strategy. But he says his request to remove his name was not honoured.

David Trahair, a Toronto chartered accountant, wrote a book urging Canadians not to invest in RRSPs before paying off mortgages and other non-deductible debt. He disapproves of swapping one loan for another.

"I recommend the total opposite, paying off your principal residence and not borrowing against it," he says.

"It's a high-risk strategy because you're betting the farm that some investment adviser can do better than you can. You have a guaranteed return from getting rid of the mortgage."

Love it or hate it, the Smith Manoeuvre is a runaway success. It appeals to those who want the best of both worlds, paying off a mortgage while building an investment portfolio at the same time.

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