Leveraging: Borrowing to invest[1]

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If you are an investor who makes regular contributions to your non-registered investment accounts, there is a strategy available that may allow you to increase your net worth over the long term and make your regular contributions tax deductible.

Many investors make regular contributions to their non-registered investment accounts. These include high income earners who have already maximized their Registered Retirement Savings Plan (RRSP) contributions and are looking for additional ways to save for retirement, those who have just started to save for retirement and have a long investment horizon, and anyone else who finds that regular contributions make sense for them.

If this sounds like you, then borrowing to invest may be of interest. This strategy involves taking out an investment loan and using your regular contributions to your non-registered investment account to pay the interest on the loan. The interest payments are generally tax deductible, effectively making your contributions deductible. At the same time you now have the potential to significantly increase the value of your non-registered investment portfolio over the long term as you have a large lump sum working for you right away that can take advantage of the benefits of compounding.

Utilizing a leverage strategy with a segregated fund contract provides the additional benefit of the potential for creditor protection. This may be particularly attractive to professionals and business owners. Furthermore, if a beneficiary other than your estate is named the death benefit will flow outside of your estate and avoid the resulting fees and delays.

[1]Borrowing to invest may be appropriate only for investors with higher risk tolerance. You should be fully aware of the risks and benefits associated with investment loans since losses as well as gains may be magnified.

HERE'S HOW IT WORKS

STEP 1: Take out an investment loan.

STEP 2: The amount of the loan is applied in a lump sum to purchase non-registered investments.

STEP 3: The loan interest is paid with the regular cash flow you were contributing to your non-registered investments.

STEP 4: The loan interest becomes a deduction on your tax return.[2]

As you can see, it's a simple strategy – and it can make a big difference to your bottom line.

HOW BORROWING TO INVEST CAN WORK

Liz is looking for ways to maximize the value of her non-registered investments and supplement her other retirement savings. She currently contributes $300 a month or $3,600 a year to her non-registered portfolio. Here's how Liz's strategy looks using this leverage strategy.

Assumptions

Annual non-registered contributions	$3,600
Annual rate of return	7%
Loan interest rate	6%
Taxable portion of return	25%
Tax rate on investment income	25%
Marginal tax rate	40%

For illustration purposes only.

How Liz's situation stacks up

The $300 that Liz can afford to contribute each month is now used to cover all borrowing expenses. Liz gains the benefits of having a lump sum ($100,000) invested immediately earning compound returns, and the monthly contributions used to pay the interest expense being tax deductible.

What it looks like at year 10

At the end of 10 years the after tax value of the $100,000 leverage account (after the loan is repaid) is $82,208 vs. $55,812 which would be the after tax value if Liz had simply invested the $300 a month each year. By utilizing the borrowing to invest strategy Liz has increased her net worth by $26,396. After taxes are paid on the annual taxable distributions in the leveraged account, the interest deductions over 10 years have reduced her taxes payable by $17,955.

Determining the amount of the loan

Liz's regular non-registered contributions will carry an interest-only loan of $100,000, calculated as follows:

$$\frac{\text{Annual non-registered contributions}}{1 - \text{Marginal Tax Rate}} \div \text{Assumed Interest Rate} = \text{The amount of interest-only loan Liz can carry}$$

$$\frac{\$3{,}600}{1 - 0.4} \div 0.06 = \$100{,}000 \text{ Loan}$$

[2]Actual tax deductibility of loan interest depends on a number of factors with the *Income Tax Act* (Canada) providing the framework for deductibility. Results for Quebec residents may differ due to the different interest deductibility rules. Readers should consult their tax and legal advisor with respect to their particular circumstances.

IDEAL CANDIDATES

- Individuals currently making regular contributions to their non-registered investment accounts
- Have a long term investment horizon

It is important to remember that this strategy may not be appropriate for someone with a low risk tolerance.

TAKE ACTION

Consider:

- Adding a leverage loan which may accelerate the investment growth of your non-registered assets
- Using your regular contributions to fund tax-deductible interest expenses on an investment loan

Individuals who have non-registered investments and non-deductible debt (such as a mortgage or car loan) may have an opportunity to increase their tax savings. By selling their non-registered investments,[3] using the proceeds to repay part or all of their existing loan and taking out an investment loan to re-purchase their investments, they can convert their non-deductible debt to deductible debt.

[3]One must consider any potential tax implications or fees on the sale prior to using such a strategy.

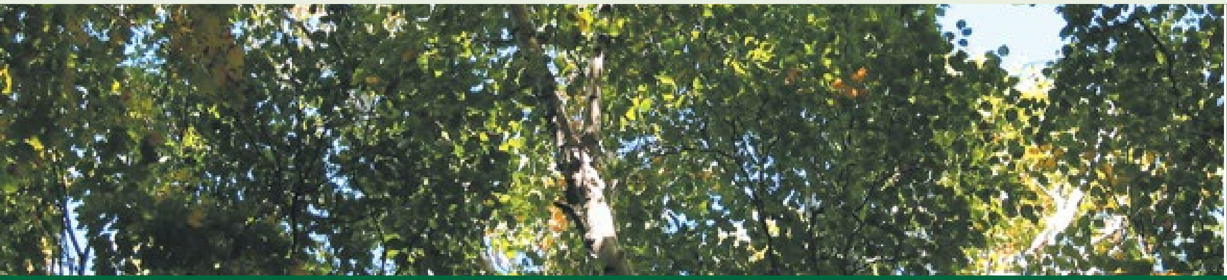
INVESTMENT OPTIONS WITH MANULIFE INVESTMENTS AND MANULIFE BANK

Manulife and its subsidiaries provide a range of products and services for investors:

Manulife Mutual Funds provides "best-in-class" portfolio management expertise for our family of funds. Manulife utilizes experienced fund management firms with proven track records for building wealth while managing volatility in varying market conditions. Our broad selection of mutual fund options provide the ability to build fully diversified portfolios to suit a range of investors' needs.

Manulife Segregated Fund Contracts combine the growth potential offered by a broad range of investment funds, with the unique wealth protection features of an insurance contract. Through Manulife segregated fund contracts, investors can minimize their exposure to risk through income, death and maturity guarantees, potential creditor protection features, and estate planning benefits – all from a single product or insurance contract.

Manulife Bank Investment Loans allow investors to make a large initial investment contribution and benefit from the potential for compound growth and interest deductibility. These loans are available for a variety of Manulife Mutual Fund accounts and Manulife segregated fund contracts, and offer attractive options such as 100% financing, no margin-calls, interest-only payments and a one-step application process.



Borrowing to invest may be appropriate only for investors with higher risk tolerance. You should be fully aware of the risks and benefits associated with investment loans since losses as well as gains may be magnified. Preferred candidates are those willing to invest for the long term and not averse to increased risk. The value of your investment will vary and is not guaranteed however you must meet your loan and income tax obligations and repay the loan in full. Please ensure you read the terms of your loan agreement and the investment details for important information. The dealer and advisor are responsible for determining the appropriateness of investments for their clients and informing them of the risks associated with borrowing to invest. For Manulife Bank Investment Loans, Manulife Bank of Canada acts solely in the capacity of lender and loan administrator and does not provide investment advice of any nature to individuals or advisors.

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