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Subsidy or COLA: Which program fits?

**The Virtues and Benefits of
Mortgage Subsidy Programs**



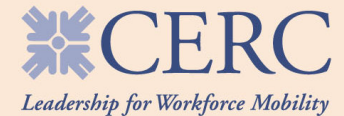
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Head of Centralized Sales, CIBC Mortgages & Lending





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Key Challenges

Market

- **Costs**
- **Supply & Demand**
- **Regional disparities**
- **Interest rates**
- **Penalties**
- **Market stability**

Employer

- **Recruitment**
- **Retention**
- **Cost-effectiveness**
- **Tax-effectiveness**
- **Employees “in the driver seat” – selling home for profit**
- **Housing Supply / Demand**
- **Relocation Policy**

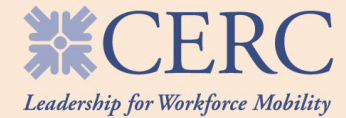
Employee

- **Family/Spousal reality**
- **Cost of living**
- **Mortgage qualification**
- **Tax-effectiveness**
- **Right financing solution**



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Mortgage Subsidy Benefits





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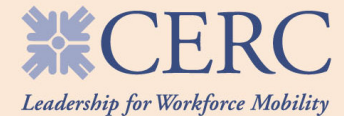
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**A Mortgage Subsidy is the best
vehicle to ensure on-going
affordability, tax-effectiveness
and cost-containment.**



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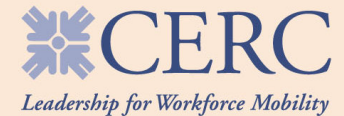
Mortgage Subsidies – Defined

- **A Mortgage Interest Subsidy is a tax effective vehicle allowable through CRA and implemented as part of a company’s benefit program and/or relocation program**
- **Employers can subsidize all or part of the interest portion on an Employee’s mortgage**
- **Tax effectiveness is measured against the “Prescribed Rate” set by CRA**



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Subsidy Rules

- **Each dollar subsidized is equivalent to \$1.45 in income – better value, increased Employee perception**
- **Cost-containment: Employers can provide dollar for dollar value – no need to gross up income**
- **Mortgage subsidy is amortized with the mortgage term, therefore helping retain valued Employees – i.e., “golden hand-cuffs”**
- **Individual must be “employed” by the company – receiving a T4**
- **Mortgage must be granted by “virtue of employment”**
- **Subsidy must be paid from Employer or 3rd party representative (i.e., relocation company) directly to HLC**
- **Subsidy start date coincides with first mortgage payment date**
- **Subsidy must be applied on the Employee’s principal residence mortgage**



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Prescribed Rate

- **Prescribed Rate (PR) is set by Canada Revenue Agency (CRA) as an annual interest rate that will apply to any amounts owed to the CRA and to any amounts the CRA owes to individuals and corporations.**
- **PR is based on Government of Canada's 90 day T-Bills – always a whole number and is set each calendar quarter**
- **Website: <http://www.cra-arc.gc.ca/nwsrm/rlss/2008/m06/nr080602-eng.html>**
- **Current Prescribed Rate is 3%**



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Home Relocation Loan

- **When Employees relocate within Canada, CRA allows an additional benefit.**
- **Employers can subsidize 100% of the interest to a maximum of \$25,000 when an Employee buys a new principle residence that is at least 40 kms closer to the new work location than previous home**
- **This is especially important when Employees are moving to a higher-cost community, as a significant cost to the Employee is the increased interest portion associated with the higher mortgage amount**
- **When used effectively, the subsidized rate can go below Prescribed Rate without incurring a taxable benefit**
- **Employees relocating from outside of Canada can still benefit from the \$25K at 0%, however will incur a taxable benefit**



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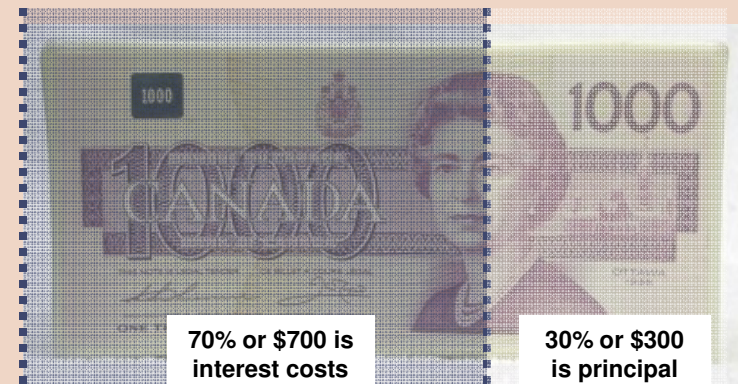
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Mortgage Subsidy “Mechanics”

- Employers can subsidize all or part of the interest portion of an Employee’s mortgage payment
- While 100% of the interest portion is eligible for a mortgage subsidy, only that amount that is above “Prescribed Rate” is “tax-free”
- A mortgage subsidy can be applied for however long an Employer determines, however, Prescribed Rate is reset every 5 years
- Subsidy cannot be attributable to “principal” portion of mortgage payment – automatically deemed as taxable income

Mortgage payment of \$1000 / month

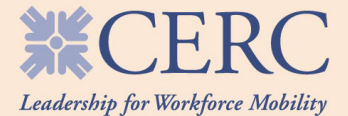


- 100% of interest portion of mortgage payment is eligible for subsidy by Employer
- A tax-free benefit is determined by how much of the subsidized portion (if any) is above Prescribed Rate



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Mortgage Subsidies are always tax-effective.

Mortgage Subsidies can be set up to be 100% tax-free.

A taxable benefit only occurs if the Employee's net interest rate is below Prescribed Rate.



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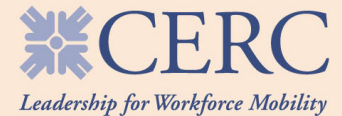


How the Prescribed Rate Influences Tax Effectiveness

- Prescribed Rate is locked in on day of mortgage funding
- Acts as a ceiling rate to a maximum of 5 years
- If Prescribed Rate drops during the term, the Employee benefits from the lower Prescribed Rate – therefore increasing the “tax-free” benefit



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Tax-Free Mortgage Subsidy

- A tax-free mortgage subsidy is achieved when the net Mortgage Interest Rate is equal to or higher than Prescribed Rate on day of funding. The mortgage subsidy is guaranteed to be a tax-free benefit for term of mortgage



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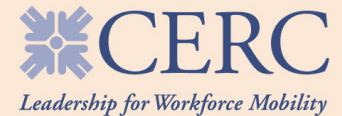


Taxable Benefit Mortgage Subsidy

- A subsidy is a taxable benefit if the net Mortgage Interest Rate is lower than Prescribed Rate on day of funding. However, if Prescribed Rate decreases at any time during the term, Employee benefits



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Home Relocation Loan (\$25,000 @ 0%)

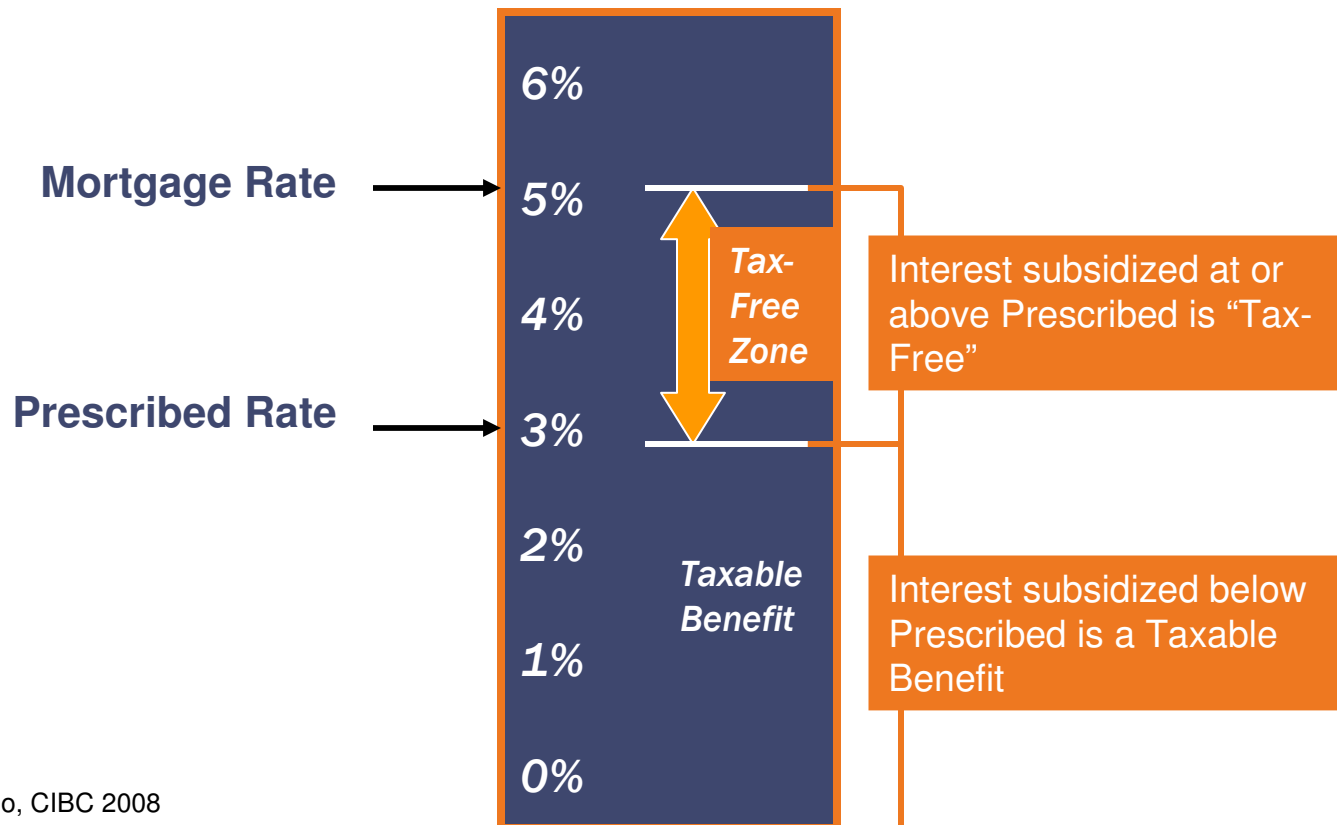
- When a subsidy is combined with a Home Relocation Loan, the net rate can go below Prescribed Rate and **not** incur a taxable benefit



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**The distance between the mortgage rate and
Prescribed Rate is the “tax-free zone.”**





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**Combining
“Mortgage Buy-Down”
with
Mortgage Subsidy**



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Baseline Mortgage Example:
 Mortgage Amount: \$433,000
 Housing Differential: \$150,000
 Mortgage Term: 5 yrs
 Mortgage Interest Rate: 5%

Combining Mortgage Buy-Down & Mortgage Subsidy

	Baseline	Mortgage with Subsidy	Savings Compared to Baseline	Buydown plus Subsidized Mortgage	Savings Compared to Baseline
Buy -down Rate	N/A	N/A	N/A	3%	N/A
Net Subsidized Rate	N/A	3.268%	↓1.8%	1.961%	↓3.039%
Monthly Payment (P+I)	\$2,518	\$2,109	↓\$409	\$1825	↓ \$692
Total Employee Interest Paid to End of Term	\$101,338	\$65,540	↓ \$35,797	\$38,950	↓ \$62,387

For illustrative purposes only



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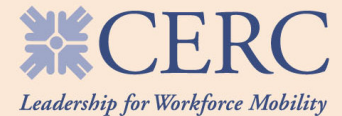


Long-Term Benefits

- The nature of Mortgage Interest Subsidies means that the benefit is continuous, i.e., over a number of years, determined by the Employer
- It is also a benefit that could substantially impact an Employee's net worth and financial well being
- Every dollar spent on a mortgage subsidy is equivalent to 1.45x in equivalent income
- Employees will consider carefully the impact and the future, potential loss of this benefit before leaving the company



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Long-Term Tax-Effectiveness

- The ongoing nature of Mortgage Interest Subsidies means that tax effectiveness is also ongoing
- Each subsidized dollar given up means the additional loss of the tax effectiveness of that dollar



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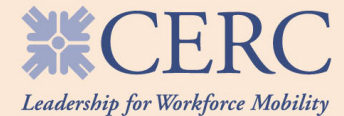


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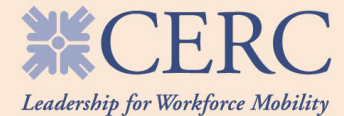


Designing the Right Mortgage Subsidy Program

- **The design of a subsidy program determines short-term or long-term impact**
- **Key considerations include dollar amount, time period and escalating or declining value**
- **Subsidized mortgages are only available on Fixed Rate mortgage term products for several reasons, namely:**
 - **The rates on Open or Variable mortgages fluctuate, adjusting whenever Prime Rate changes – therefore, Employees could incur an unexpected taxable benefit on a month-over-month basis**
 - **In the Province of Quebec, two Prescribed Rates are applicable: federal and provincial – possibly resulting in a provincial taxable benefit and a federal taxable benefit**
 - **Fixed rate mortgage allows for certainty – mortgage subsidy could be set up from outset to “guarantee” a zero taxable benefit throughout term of mortgage**



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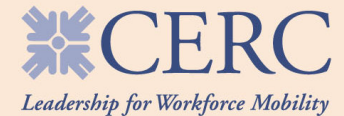


Mortgage Subsidy Benefits for Employees

- **Tax-effective benefit – one of the few programs available that helps compensate for the high cost of relocation**
- **Reduced monthly payment means more disposable income**
- **Mortgage payment can be maintained at “Contract” rate – a tax-effective way to pay down mortgage principal faster and shorten amortization**
- **Financial assistance received at the beginning of the mortgage - when real interest costs are highest**
- **Every dollar of subsidy equates to 1.45 of taxable income**
- **An attractive benefit – even if Employees incur a partial taxable benefit – better than taxable income**



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Mortgage Subsidy Benefits for Employers

- **Tax-deductible expense for corporations**
- **Attract and retain employees – mimics mortgage interest deductibility in the US**
- **Increased employee satisfaction and willingness to relocate**
- **No company guarantee required for employee financing - employees qualify on their own standing**
- **No financial risk to organization - no capital expenditure or direct administrative costs**
- **Cost savings vs. other methods like “grossing up” payroll cost more for the same value**
- **Subsidies not subject to C.P.P. or E.I.**
- **Increased buying power means equalization for all employees**



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Employers often refer to Mortgage Subsidies as the “golden hand-cuff” benefit. Employees think twice before giving up this tax-effective benefit, that reduces their biggest, single cost – home ownership.



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Thank You!
Merci!