The "Smith Manoeuvre" Featuring – Fraser Smith

The resources mentioned on this call and BONUS materials are included at the end of this transcript.

Mark Huber: Fraser, I think without too much introduction or talk from us, everyone is obviously online wanting to hear from you. So perhaps you can start out by giving a brief history and then talk to the Smith Manoeuvre and the essence of what it does, and then we can carry on with talking about the new strategy that you have developed using the Smith Manoeuvre for unincorporated businesses as well as rental property owners, the cash flow one and two, so you're on.

Fraser Smith: Thanks, very much. Thank, Mark for having me on today. Thanks, ladies and gentlemen for taking some time out of your day. My attempt here today is to show you how you'll be able to get free tax refunds from the government, pay off your mortgage faster and, at the same time, build an investment portfolio. All these events are going to happen simultaneously if you employ the Smith Manoeuvre, and the other thing is that none of this requires any cash from your pocket. In fact, you'll see you'll actually end up with a new cash flow stream courtesy of the tax department, and I doubt if many of you will turn that down when it happens. We probably have Revenue Canada listening on the line now which is fine. They've been here to see me in times past, and I nearly made a client out of the short fellow who wondered if it would work with an $88,000 mortgage which pretty sure was his own. The history of me is 67 years long now. I retired a couple of years ago to write this book. My early history's Alberta, and I went to school at the University of Alberta. That's where I met my wives, and actually, I only have one wife, and I went on to work with Xerox of Canada for ten years. And I was general manager for B.C. for four years which is how I came to know that I was going to die out here some day. That's a ways off yet. I have a couple of grandchildren as well and I'm a very happy fellow because now I spend all my time talking to people like you, trying to ensure that everybody has a chance to say "yes" they'd like to make their mortgage tax deductible. I got interested in this topic years ago as a young financial planner. 1980 is when I started, and I was fascinated by the fact the Americans were deducting the interest on their mortgage and we poor Canadians had no such luck. And I did spend time with *The Tax Act* which is a terrible book, hard to read and very dark in there. But I did come up with a few gems hidden away and over time came up with an idea that I thought if I could get the help of a good banker, I could show people how to make their mortgage tax deductible and do it legally. And I got turned down by the Royal, the Montreal, and a couple of others but finally landed at VanCity and met with Larry Bell, who was the president of VanCity at the time and currently the chairman of B.C. Hydro, you may know. And I had a chat with him and his question to me was, "Why isn't every Canadian making their mortgage tax deductible?" So I made a friend and got going on my project. I set up a financial planning company and a securities firm and did that for about 20 years, keeping it quiet because I didn't want my competitors to have my concept. I worked with VanCity and, over time, made quite a business out of it but had made a determination that I would write the book when I retired. And I did retire at age 65, wrote the book and it's now sold 12,000 copies across Canada and I do seminars. And so today I'm doing one by telephone, and I'm glad to do it, to talk to all you people, to help you to understand how to make this work for your family. I usually start by making sure you understand that the-- how I separate the people of Canada, if you like, and I do it on the basis of who's wealthy and who's not. Essentially, if you took a pyramid, the top ten percent of the pyramid would represent the people of Canada who own half of the net worth of Canada. Ten percent of the people own half so arbitrarily, I just say, "Well, the other 90 percent are the not wealthy people." It's not that they're poor, it's just that they're not wealthy. And that probably includes most of you because I think most people who have a mortgage don't necessarily consider themselves to be wealthy people. So today when we're going through this, I'll be speaking to you directly, assuming you're in that category. The problems are many for Canadians, the main one being that our standard of living is dropping, and you've probably seen that in the papers. Over the last few years it's been dropping and that's largely because our taxation has been rising. It doesn't get a lot better over the years and there's nothing much in sight here yet considering all the crime and corruption that's going on. We can see where a good portion of it might get cleaned up if we can change the government. In the meantime, though, taxation is a big enemy. You may know that Vancouver has the Fraser Institute which, I'm sure, you assume is named after me, but it's not. It's named after the Fraser River but, of course, it is named after me, and so the Fraser Institute came out with the concept of tax-freedom day. And you may know that it's now up to June the 28^{th} where you're working for the governments, in all forms of taxation, not just income tax but GST and so on. And so about half your life is spent on taxation. That's one of the beautiful fits of the Smith Manoeuvre is that it gains one of its prominent abilities here because it is going to show you how to recover that tax and reduce your tax bill. And there won't be many fighting that, either. The other point I deal with is that we have the phenomenon of the Canadian Dream which is where, at a young age, we take on our first mortgage, and it's usually the biggest loan we'll ever take. We can't believe the size of it but we need that house, there's a baby coming or whatever, and once we get it then we listen to grandpa who said, you know, that debt is bad. You get it paid off as fast as you can. And you say, "Well, I need it to build an investment portfolio so that I'll have something for my retirement," and grandpa says, "Well, you do that after you get the mortgage paid off." And so so many people in Canada make a very big mistake, in my opinion, and that is to spend the prime earning years of their life fighting with the mortgage, trying to get it paid off, hoping that when it is, they'll be able to start an investment programme. If we have somebody who is in the category of just making it, let's say they have a mortgage and they're just managing. They don't have enough money to have other investments but they are making their payments and they're good citizens. These people carry on and at age 65, they meet the Canadian Dream because they're going to burn their mortgage and show their gold-service watch for 40 years of service at Stelco or whatever. And on the same day they get rid of their mortgage and they burn their mortgage and they retire. They've made it. And within a very short period of years, it's likely and it's common, getting more common, where suddenly they realize they don’t have enough income. And they end up with a reverse mortgage and you know that somebody thinks there’s going to be a lot of money in reverse mortgages because we see Gordon Pape on the TV about three times an hour, 24 hours a day for the last two years. The banks are very anxious to get us trained to be ready to take reverse mortgages. So our young person, the bank owned his house when he took his mortgage at age 25 and they’re going to own the house again when he dies at age 80. And the Canadian Dream has turned into the Canadian Nightmare. So even if there’s only a few people in that category across Canada, it tells you, then, all the rest of us, you know are some level above that, perhaps, but there is an opportunity if we use the Smith Manoeuvre and we’ll be able to avoid that scenario. If it’s good for somebody who’s going to be in trouble in their retirement, then obviously it’s good also for somebody like you who isn’t going to be too bad off but if we could be better off with no great strain, then perhaps that’s worth examining. And that’s what is being offered here today. And so the solution for a lot of this, then, is to enter into the programme which is to utilize the Smith Manoeuvre. In words, the Smith Manoeuvre is a financial strategy designed to convert the non-deductible interest debt of a house mortgage to the deductible interest debt of an investment loan which simultaneously ensures the building of a free and clear investment portfolio. Free and clear is very important, and I'll come back to that. The way that it works if you imagine two elevators side by side in the same shaft and a rope goes up and over. One elevator's up at the top, the other's on the main floor. And as the elevator on the left starts to come down, the one on the right has to go up. As fast as the elevator on the left comes down, the one on the right goes up. Finally, the left-hand elevator gets to the ground, and the one on the right is up at the top of the shaft. And this is how we're going to start to explain how the manoeuvre works. Most people take the mortgage as we were saying with the idea of getting it paid off and then investing. The problem with that is that it leaves us too late in life to be taking advantage of the compounding growth of investments. The house might have done very well but, of course, it would in either scenario so we'll set that aside. We're talking here about having investments to retire upon. And if we're following the traditional Canadian Dream scenario, we said there, there was no investments, there were no investments being accumulated. If, on the other hand, we hold up on paying this mortgage off and make an agreement with ourselves that as long as the mortgage does not increase in total, would we be happy to take back that equity each month as fast as it's generated and put that money to work? And we're able to do that under the Smith Manoeuver because the arrangement with the bank is that if you pay something off on your first mortgage, we're going to be able to borrow it back and use it for investment. Borrowing for your house is the same as borrowing for a vacation. The government does not let you deduct the interest on your house mortgage, and you're paying a lot of it every month, of course. On the other hand, if you borrow to invest, expecting to profit, then the government says "Fine, you may deduct the interest on that loan." And that's the kernel of truth here is that if that's the case, then, the problem that we've got is that we took a very big loan from the bank to get our house, and we got the house but we have a loan that is the wrong kind. Unfortunately, it is a non-deductible interest loan. And so the objective of the Smith Manoeuvre is simply this: if you've already got the debt, and it's the wrong kind, let's convert it to the good kind. To do that, we have to change our opinion of what is required of us here regarding our debt and recognize that if we're willing to let our debts stay constant from where it started through the piece, out through the years ahead, then it will allow us to do this conversion that I'm speaking of and convert the whole of that debt until the interest is a tax deduction. And we're talking an awful lot of money here. We're talking about very large tax deductions. This is not a programme that is coupon clipping. We're talking about thousands and thousands of dollars if the mortgage was tax deductible. So with the elevator analogy we're talking about the house mortgage at the top of the cage coming down, and simultaneously, the cage on the other side rising because as fast as we pay off the mortgage, we're borrowing the money back and we're investing it. And you're able to invest in anything that you want to invest in. You can invest in stocks and bonds, mutual funds, you can invest in somebody else's business, your own business, you can invest in investment real estate.

Just about anything that you can think of for investment purposes will qualify to yield deductible interest. And so most of us would like to be having investments in our portfolio in any event. It's just that the mortgage seems to be in the way. It's our enemy and so we're fighting to pay it off, and I'm suggesting that if you follow my advice here, you'll convert your enemy to your friend. The bank loves the mortgage business. It's their life blood and in their case, they have time playing against you. What happens here is that we turn around and make time your friend. Now in the end, you think, "Well, the banks will fight that. It sounds like the bank will then become the loser." But that's not the case. Larry Bell was quick to show me that I missed a very important point talking to a banker and that was that a banker is out there every day trying to replace the business of all the people who made mortgage payments today. Yes, their mortgage went down but, of course, that's the bank's asset. And so their asset dropped as well. And that's why they're out there hunting around for other people to put mortgage money to in order to keep the cash flowing in in the form of interest on loans. And so what happens in the Smith Manoeuvre, then, is that the loan, in fact, stays the same. It could be for the rest of your lives. The objective for my clients was that they carry that debt for the rest of their life. My objective is they die at age 130 still owing Larry Bell $200,000 on a mortgage. The difference is that for the last hundred years or 50 years it's been tax deductible so that there are tax deductions coming on this interest every year for the rest of your life. And, of course, when we get that tax refund, the whole objective here is to use that money to pay down the first mortgage with an extra payment, an over payment. This is found money. It wasn't going to happen unless you did the Smith Manoeuvre so if you're wise, you'll take those tax refunds, pay down your first mortgage and because you've paid it down, Larry Bell's willing to give it back to you the same day so that you can go out and buy some more investments. Your investment portfolio grows rapidly, your mortgage goes down rapidly, your total debt stays the same. So your debt does not increase when you do the Smith Manoeuvre. It stays the same. That's a very important point, and there's no cash required from you in this scenario. You know that the bank is always pushing, "Make your payments bi-weekly and we can knock $20,000 over the whole of your mortgage life." And that's true. But that's still money that you have to pay from your pocket over and above your regular payment. It's incremental cash from your cash flow that makes that happen. So while it's good, it still requires cash from you. The Smith Manoeuvre requires no cash from you. In fact, to the contrary. Those tax refunds are going to come to you free and clear only because you converted your debt from the bad kind to the good kind. And so in truth, your family is actually going to have an incremental cash flow that they didn't have before, and I'm suggesting that you'd be wise and use it to reduce your mortgage even faster. That is the objective, to get your mortgage done as quickly as possible. The shorter time that you use to convert this mortgage, the more net worth you're going to have in your portfolio as a result. Shorter is better with mortgages. So in the hand-out that you printed off there, you'll see the logo of the Smith Manoeuvre in the bottom right-hand corner of the second page. This is another way to describe how the Smith Manoeuvre works. It's maybe a little hard to read but you can see there's a graph there. That's actually a 25-year graph. The vertical bars are five years apart, and the horizontal bars represent the amount of your mortgage. You'll see a line that's level. That's at $200,000. And so this is a $200,000 mortgage that starts at 200 and ends up at zero in the bottom right-and corner. You'll also see a line that's a little shorter than that. It ends at about 22 and a half years. That is the representation of a person here who has a $200,000 mortgage at seven percent for 25 years. They're intending to pay it off over the full 25 years. If they do the Smith Manoeuvre here, the shorter line shows that they'll knock three and a quarter years off their mortgage. Then there's a line above it that goes up to the flat line. That represents the money that they're borrowing back. Those two curves are reverse images of each other, and it simply says that as one goes down, the other goes up. And then there's a tall curve and that shows what happens to the investments that you're purchasing each month as your mortgage goes down, you're able to repurchase investments. And that total there is $500,000. If you do the manoeuvre, it's saying at ten percent growth, your investment portfolio would be $500,000. Yes, you will have $200,000 of debt still but it will be deductible, and the net difference is approximately $300,000 net benefit to you for having done that with no money from your pocket, money from Revenue Canada and the main reason that it is doing that is that you've shortened the amortization, and you've had compounding happening for you, to your benefit, over the last 25 years. It starts immediately. There's no delay. And you start to build your investment portfolio virtually at the minute that you start the programme. Now if we can shorten that time interval even more, then obviously the red curve has a chance to grow even higher. And if you read the book or you go to the website, you can see there what happens as we start to do other techniques. There's a technique that's been around for years called the Death Swap. You know it, probably, as taking a second mortgage and going and borrowing that money to invest. You buy a lump sum of investments, you trust they're going to grow for you over time, and in the case of the Death Swap, we sell off investments that we already own, use the money to pay the first mortgage down in a lump sum and immediately borrow the money back the same day and get it invested again. When we do that, we force the mortgage rapidly to drop, and we then have more compounding time because we're going to be able to invest the money that we were paying into the mortgage. We're going to be able to invest it over the length of the original mortgage, and those compoundings are even more valuable than the tax refunds that we're receiving from the tax department. The legality has been tested in court. Another Vancouver event, in fact, a lawyer in Vancouver tested this right through to the Supreme Court and proved, once again, every once in awhile, government does attempt to take a run at the concept of deductibility of interest and continues to fail miserably and I hope that is always the case. They are attempting now to do that again and nothing much has been happening and the suspicion is that if they do attack it in any fashion, it'll be much changed from what they were originally proposing. The problem with it is that some people are in a position of deciding that they'd better not be investing in case the interest deductibility is taken away. Most professionals think that's not likely to happen. We'd be the only industrialized nation not to have deductibility of interest for investment and that isn't likely to happen.

When we total up the net benefits of the Smith Manoeuvre here, we're talking, depending on your circumstances, it could be talking, you know, $600,000, $700,000 worth of net-worth difference simply for the fact that we have reorganized our financing. It's-- you don't necessarily have to change the bank that you're at now. We're able to do these now at most banks. A good mortgage broker -- he knows which banks are offering these services and your bank may or may not be there but there are other ways to handle it if they're not. And the assistance of a good planner is highly recommended by me and a mortgage broker and the two of them working together is a very strong combination. Subsequently, I've introduced another programme called "The Cash Flow Dam" which still does not require any cash from you and it requires no new money. It's a reorganization, again, of your finances, and this applies to any of you who have your own business that is unincorporated or have a rental business, a rental house, a rental property which is really, just a business. If it's unincorporated, then you're allowed to do the cash flow dam. Essentially, it's very simple. Most people have set up their business separate from their private. They have a bank account for their business, and they have their bank accounts for their private personal situation. And it's exciting to go out and get your cheque book for your new business, and you end up paying the mortgage for your rental property out of the revenue you get from the renter. This is a very serious mistake. If any of you are doing that, you'll like this because what you should be doing is paying the expenses for your revenue house, including your mortgage, from your Smith Manoeuvre investment credit line. If you use the money from there, then, of course, that means that the monthly rental from your renter is sitting there doing nothing so what you do is you use it to apply against your first mortgage on your own house. And, of course, if you're already paying a thousand a month mortgage on your own house, and now you've got another thousand a month from the renter of the revenue house, your mortgage is going to be gone in five years instead of 25. Having paid down the-- your mortgage extra, then that gives you room to have accommodated borrowing the money to pay the expenses. This is totally legal. You're following the rule that says that-- it passes the test which is "What did you do with the money when you borrowed it?" The answer in this case is, "I borrowed the money to make a mortgage payment and pay the expenses on a revenue property business that I own," and the tax man says, "Fine. You can deduct the interest on that." The tax department does not tell you what you have to do with the revenue you receive from a renter. Most people are doing this mistakenly. Many accountants don't explain it to them. It's a very, very, very powerful way to speed up and accelerate the paydown of your mortgage. It's the same if you have a family business that is unincorporated. It does not work for an incorporated company. That's important. So your uinincorporated business has expenses. Don't pay them with cash that the business earns. Pay them with money borrowed from your Smith Manoeuvre investment credit line, and that will allow you then to flow the proceeds from your business against your first mortgage. Now after the mortgage is converted and it will be a very short period of time, then you can resume what you were doing before. But in the meantime, you will have many, many extra dollars here because your mortgage will be shortened up that much more. This concept is hard to quantify unless you have a device called the Smithman Calculator which is a CD which we publish which allows you to quantify the circumstances that I've been relaying to you. So when you sit with your planner, he'll be able to tell you, to the dollar, making assumptions on what you have, what your cash flow is, what your revenue property is, say, "What will the results be for you if you do it my way versus the way you're doing it now." It's in dollars and is very precise. It'll never be right, of course. There are lots of changes coming for all of us in the future, but in the meantime, based on current law and based on your assumptions, you will be able to quantify this and, as I'm saying, this is-- we're talking thousands of dollars. We're not talking small amounts of money. For the average person, this is an exceedingly important thing for them to be doing. It's important, too, to recognize that the investments that you're gathering when you do the Smith Manoeuvre are free and clear. That means, then, that if you ever got into trouble, you lost your job, say, which is one of the worst things that can be happening to somebody in Canada, you know, outside of death, when that happens, somebody who has no other resources can be in trouble and could lose their house because they can't make the mortgage payments. Nobody on the Smith Manoeuvre would ever let their house go because obviously if they're following the Manoeuvre, they're gathering investments in a portfolio which are free and clear. The reason they're free and clear is that the house is the security for the investment loan and not the investments that you're purchasing. Because the house is the security, it also yields the lowest rate of interest that you would pay for borrowing money to invest. Usually, our clients are borrowing at prime to invest and then it's tax deductible on top of that. If you're borrowing at four and a quarter percent, it'll be 40 percent cheaper than that if you're at the 40 percent tax bracket you're down around two to three points as the cost of your money's exceedingly low and then, therefore, you only have to earn that over time in your investments. If they're doing better than two and a half percent or three percent after tax, then you are obviously making money using somebody else's money. And I guess that's what wealthy people learned a long time ago is number one, if you have any debt, make damn sure that it is tax deductible debt. Wealthy people have carried-- they carry lots of debt but I assure you the difference between their debt and yours is that theirs is tax deductible. It's the first thing their accountants and lawyers do for them is set them up to ensure that any debt they have is a tax deduction. And it's very unfortunate that the people who need the help the most, the 90 percent in our pyramid who are ordinary people, they don't have the training, they don't have the advice, they can't afford the lawyers and the accountants. And so they carry on, all their life, carrying non-deductible debt, credit cards, their borrowing is for cars and boats and vacations and the wealthy are looking at them, totally bemused, "Why do they do that?" And the wealthy do not do that. The wealthy borrow to invest. The wealthiest borrow to invest. Warren Buffett, the second wealthiest man in the world just borrowed $3.7 billion. He sold bonds against the security of his company last month, $3.7 billion. And the wealthy get wealthy on other people's money and the ordinary people spend the rest of their life trying to pay off a mortgage that is non deductible. It's kind of sad, really and most people-- many people are certainly in that category. And it's very unfortunate, in my opinion, and I consider that one of my main things to do in life now is to teach as many people as possible that they have to manage the debt now, manage it in a fashion that gives them assets for the future so they don't have to rely on the reverse mortgage. People who have assets in this fashion, gained because they're doing the Smith Manoeuvre, will not be needing a reverse mortgage. They will live off the assets that they build, free and clear, in their investment portfolio, and they won't care much if they've got a six-figure mortgage debt for the rest of their life in the form of a deductible interest loan if their investment portfolio is seven figures. Wealthy people die with tons of debt. That's not how they keep score. You keep score by what you own minus what you owe. Net worth is the score, not the fact that you have no debt. Zero debt is the wrong way to go, in my opinion, and it's certainly showable mathematically using the calculator. It takes no time at all to explain to somebody, "Here's your choice," and so many people after they see it, make the choice. It becomes very obvious that the right thing to do is carry debt but carry the right kind of debt. The point being that you already have the debt. I'm not suggesting you get into debt. You already are there because you have a house mortgage. I'm suggesting you convert the debt to the good kind of debt. After it's converted, it's your choice. If you want to pay it down, you can. If you're so debt adverse that you insist on having no debt at all, at last get it converted to the good kind which will build you up an asset portfolio, and then if you really have to, then go ahead and pay that loan off. But the problem with that is, of course, that your tax deductions will start to drop as the loan gets smaller and on top of that, it implies that you're using your cash flow to reduce a loan which is deductible, therefore, that cash is not being used to purchase assets. Like squirrels, we should be purchasing assets for the rest of our lives. We don't know when we're going to die and, therefore, the urge is to collect the nuts, and the mathematics now show you that that's the correct thing to do. It's a mistake to pay off a loan which is deductible assuming your debt to equity ratio is decent. Again, you'll need the help of a financial planner like Mark to help you make the decision whether your debt is too high or too low. But the point I'm dealing with is whether it's too high or too low, you've already go it. You have the debt now and let's get it converted. That's my suggestion.

Mark had suggested that I tell you what the top-five questions that I get are, and that was a very good idea. And the first question that always comes up is, "How can we do this with no money from me? You know, every other programme to improve requires cash from me." And the answer to that question is very simple. First is that we're going to start getting free tax refunds. There's no charge for these tax refunds. They're free. They're-- it's gratis. It's a gift. A gift from the tax department and, furthermore, it isn't even taxable. Almost every other cheque that you're receiving you know you're going to be paying tax on it. In this case, there will be no tax. And so that's the first part of it. The second part is it's simply the fact that time is your friend. You gather assets now, they will compound over time and you will be diversified. You won't be making a short-term decision. A mortgage is for 20, 25 years and that's the interval of time we're comparing. And so this forces you to invest. You have no choice but to invest if you want to get the tax deductions. Another way to say it is if you want the tax deductions, you have to invest. And so either way, you end up with two advantages you weren't otherwise going to have. The two of them together are what cause you to be in a position and not to need any money from anybody else to improve your net worth. The real changes that finance-- that are out there now is the other question that always comes up, as I said earlier, it causes people to say, "Well, I don't want to invest. I don't want to take a chance if they're going to change the rules." In the meantime, the rules are the old rules and it really is a silly mistake, in my opinion, to make a decision on the basis of which finance may or may not do. Government, as we've seen in the news these days, is-- never mind looking after us, they're screwing us. And so, do your best, in my opinion. Deal with the laws that are at hand. If they change them, so they change them. In the meantime, don't make the mistake of withholding an investment programme because of that. The other question that comes up all the time is risk and that's easy. There's-- this programme is converting your debt. It's freeing up your debt to invest. The risk, then, is your risk. You with your planner will decide what you're going to invest in. I can't help you with that. But I am, as the programme frees up the money and there's no risk there, the freeing up of the money is not a risk. It's free for the asking simply for the reorganization, and with your planner, you get that part done and then as the fruits of your labour here start to come in, which is cash, you have to put it to work and there always is risk in investing and I'm not avoiding that. I'm just pointing out that that's got nothing to do with the Smith Manoeuvre. That's between you and your planner and your good luck, perhaps. The other questions are, "Should I be long or short in my mortgage?" The answer is "Never lock in your mortgage." At least from a mathematical point of view, you would never lock in your mortgage. Short and open is virtually 99% of the time, I would say, that's what you should be in. This has been statistically and mathematically proven time and time again. All planners know that and would encourage you if it's your concern is that you want to know what your mortgage payment is, then get a variable rate mortgage and the payment will be the same. And behind the scenes in there, the amortization will be moving back and forward. You won't care. Portability always comes up. "What happens if I'm three years into this and I want to change houses?" There's nothing to it. The banks are very used to a phenomenon called “Substitution of Collateral” and I won’t explain it here, but Mark can explain that to you at his pleasure. Those are the main questions that come up. In summary, the manoeuvre is there for any Canadian who has a mortgage or other non-deductible debt. And the whole attempt here is to make that debt convertible, convert it to the good kind of debt instead of the bad kind and gain the tax refunds free and gain the growth and appreciation of an investment portfolio that will be your personal pension plan when the times comes for you to slow down. I think we should have some time here for questions and answers now. We’ve got about 17 minutes left according to my watch. And so can we arrange to open the lines?

Operator: Thank you. Ladies and gentlemen, to join the question queue, please press the numbers “0, 1.” If you wish to withdraw your question, press the pound sign. So if you have any questions, please press “0, 1” now. Our first question comes from Thomas Dashooter with Edward Jones. Please proceed with your question.

Fraser Smith: Hi, Thomas. Go ahead, Thomas.

Thomas Dashooter: My question is, thanks very much for the call today, my question is, when it comes to the institutions, how does the transfer of the money work? I mean, what should we be looking at for the bank to be able to do or for a mortgage broker to be able to do to actually convert the money as the mortgage is paid?

Fraser Smith: Oh, good question, Thomas. What happens, really, is we're making use of a financial product called, generic term is the readvanceable mortgage. It simply means that the bank will, as you separate into two parts typically and your house mortgage drops, the credit becomes available to reborrow and invest in the segment (b), you know, in the right-hand side, let's say. And so the bank will calculate that number by taking 75 percent of the value of your house and they'll lend you that much to invest in an investment credit line minus whatever is left on the first mortgage. That's the calculation. And so if you have a $400,000 house appraised, they will give you $300,000 investment credit line for investment purposes, and if you have a $200,000 first mortgage, then the day that you open your account, you have $100,000 available there to invest in your investment credit line. And, as you start to pay your mortgage down, then you will recover that-- any equity that you build as you make your mortgage payments will be available to you to reborrow and to invest as well.

Thomas Dashooter: So then the bank would just send this to another account for you automatically?

Fraser Smith: Yes, that's really what happens. Well, some-- there's only one or two that are automatic. Ordinarily, what we did was we left a cushion in there, and we might do a preauthorized chequing, let's say-- pick a mutual fund, just for example, and let's say that our mortgage was dropping an average of $500 a month, while we knew that over a year then that was $6,000 and so all we did was set up a preauthorized chequing for $500 a month. And if the cushion was there, then by the time a year went by, we would have used up our cushion and then we'd go to the bank and say, "Hey, look. We've paid $6,000 off on our first mortgage. Would you kindly increase the credit limit on the investment side," and away we would go again, you see. And so it is a separate account. You need-- it's important to have two separate accounts, one for representing your old mortgage and one representing your new investment account.

Thomas Dashooter: Right, okay. Great. Thank you.

Fraser Smith: Thank you.

Operator: Thank you. Our next question comes from Alan Hinton with Maximizer. Please proceed with your question.

Alan Hinton: Yes. I just have a question. I'm in a fixed five-year mortgage. Now am I going to be able to take advantage of this system in a fixed mortgage?

Fraser Smith: Yes. That's a good question, too. I've never been stopped. I've been doing it 20 years, I've never run into a case where we couldn't make the manoeuvre work regardless of the first charge that was on the house. In the case of a five-year mortgage, you're almost certain you're being able to pay down in addition to your regular payments, as much as 10 to 20 percent and for certain, we take advantage of that. If a person had enough money available to pay down more than 20 percent, the thing to do is to set the excess aside in the bank as a savings account and collateralize it, to be able to carry on and invest that same amount of money. You must never use tax-paid dollars for anything other than paying off your mortgage or your non-deductible debt. So in the case of the five-year mortgage, you'd at least use up your 20 percent each year, and you would save, you would set the money aside and when the renewal date finally came up, then you would apply it in total against that first mortgage. And if you're following my advice almost always you would, upon renewal of the mortgage, convert to an open mortgage so that it wouldn't matter when and how you overpaid that first mortgage.

Alan Hinton: Okay. So what you're saying is you can't do it in a fixed, you just do it in a different way until you get to a point where you can renew it and then go again?

Fraser Smith: No, I am saying that any recovery that you make against your five-year mortgage you can get at it one way or the other. It's a bit complicated to explain on the phone. But it-- you will not be stopped. You would start immediately, the very first month you'd be able to recover equity and get it invested. It's not a problem.

Alan Hinton: Okay.

Operator: Thank you. Our next question comes from Travis Grubert with Circon Systems. Please proceed with your question.

Fraser Smith: Hi, Travis.

Travis Grubert: Hi, how are you doing?

Fraser Smith: Good, thanks.

Travis Grubert: I think the previous question pretty much answered mine, it's along the same line so I didn't have time to withdraw. I'll do it now.

Fraser Smith: Okay.

Travis Grubert: It pretty much answers it.

Fraser Smith: That's a big concern and it's, of course, a planner when he sees this would love to have the fellow in an open mortgage and be able to go at it right off the bat with no other consideration. But it does not preclude you at all so.

Travis Grubert: Okay, that's good to know.

Fraser Smith: So carry on, yeah. Thanks, Travis.

Travis Grubert: Thank you.

Operator: Thank you. Again, if you do wish to ask a question, please press "0, 1" now. And currently there are no questions in the queue.

Fraser Smith: Do you have one operator?

Operator: Me-- no. Well, actually, I have several but--

Fraser Smith: Oh, do you?

Operator: -- no, yeah, I do.

Fraser Smith: Is this allowed, Mark?

Mark Huber: It certainly is and is encouraged.

Fraser Smith: Oh, go ahead.

Operator: Well, no-- that's fine, but I've been listening and I'll definitely talk to my husband about it. It sounds very, very interesting.

Fraser Smith: All right. Well, glad you have a mortgage, that's good. You're a potential victim.

Operator: I am.

Fraser Smith: That's good.

Operator: Very much so.

Fraser Smith: Do you have a question, Mark?

Mark Huber: Fraser, yes, thanks for asking. I just wanted to find out, I understand you're updating your book, is that true?

Fraser Smith: Yes, I am. I'm in the process, it'll probably be out-- it'll be another-- well, less than two months, I would say.

Mark Huber: Okay. And how can one get a copy of the current edition of your book?

Fraser Smith: Oh, thank you. Yes, you can get my book at my website which is www.smithman.net. And you can also get the calculator I was mentioning, and if you get them both together there's a giant discount for the two of them together. Some people get the book first, get an understanding, and then get the calculator later but that's the place to go. Some book stores are carrying it and you can certainly get it at Amazon although sometimes it's six weeks delivery, they say. And so it's easiest off the website.

Mark Huber: Also, I just wanted-- your comment on people that have still a question mark in their mind as to the advantage of utilizing a mortgage consultant as opposed to, you know, the friendly banker.

Fraser Smith: Yes. All my years I never did use a mortgage broker. As a planner, I did my own financing but it was different for me because it took me a long time to find a bank that would do it which turned out to be VanCity. The other banks wouldn't do it because it was "irregular" was the word they used. And, of course, it was irregular. And they just didn't see the potential. Larry Bell did, which was my good fortune, and so, obviously, until the other banks came along and offered the readvanceable mortgage, then there was no sense dealing with anybody else in any event. What has happened now is that last year the last two major banks finally succumbed, took them 20 years, they're large, but their work is slow. And that was the Royal and the Montreal. The Royal was the last; the biggest was the last. And did it almost a year ago now. They came out with their readvanceable mortgage so that now a financial planner would be very wise, in my opinion, to work with a mortgage broker because the two of them together, then, are going to get the maximum rates, the maximum terms and conditions which many times are more important than rates, quite frankly. And put together a package that optimizes the cost of doing this. The-- I got very good rates, you know, you can't do much better than prime for the ordinary Canadian, and I was able to get that from VanCity so it worked fine for me. Unfortunately, VanCity doesn't operate any other place than the Mainland, the Lower Mainland and Victoria at this point in time, and so it was very, you know, fortuitous that finally the banks succumbed and brought out the readvanceable mortgage. And so because they are available and because there's other sources of money out there that mortgage brokers know and other people don't know about, it seems to me a marriage made in heaven to have the services of a mortgage broker tied in so that you know you're optimizing terms, conditions and rates all at the same time. Their objective is the same as yours. They're not paid by you, they're paid by the bank in essence and, so, they have no vested interest other than to do the very best for you, the customer.

Mark Huber: Ffurther to that, your point is well taken with the mortgage consultant in that for some of my clients who are self-employed, the traditional lending arena is a tough go for them and as you pointed out, a mortgage consultant has different suppliers who are very comfortable with the self-employed small business person--

Fraser Smith: Good point.

Mark Huber: -- and they're ready to do deals and the mortgage consultant does the leg work on behalf of the client and scouts up to the, you know, 40-odd lenders but knows immediately, you know, where to start looking depending on the client profile. So, you know, it's been certainly a marriage made in heaven, speaking from experience here.

Fraser Smith: Yeah. No, I think it's good and we're seeing that on a national basis more and more, the mortgage companies encouraging the brokers to work with planners so I think it's a sea change, you know, it's not temporary. I think that's how business is going to be done more and more.

And the homeowner is going to be the end beneficiary of that, for sure.

Mark Huber: Exactly, and that's what it's all about.

Fraser Smith: Yes.

Mark Huber: Saving wealth for clients.

Fraser Smith: No, that's right.

Operator: Excuse me. We do have a few more questions if you're willing to take those.

Fraser Smith: Sure, go ahead.

Operator: One moment. Alan Hinton, please proceed with your question.

Alan Hinton: Hi, guys.

Fraser Smith: Hi, Alan.

Alan Hinton: I have another question. You talked about the-- in your book, you talked about the rental swap for-- I think that's the words you used about using a line of credit to pay for the rental property instead of paying it directly from the renter, right?

Fraser Smith: Yes. That's a-- I call that the "cash flow dam."

Alan Hinton: The cash flow dam.

Fraser Smith: That's right.

Alan Hinton: Could you do something like that for, if you weren't renting but just paying off your mortgage? Could you use something like that to just pay your mortgage with?

Fraser Smith: Okay. Tell me what the circumstances-- like, does this person have a house mortgage and, as well, have a rental property?

Alan Hinton: No, just a house mortgage.

Fraser Smith: Okay. And so-- could they do what then, Alan?

Alan Hinton: Basically, like from what I understand, take out a line of credit and then pay the-- with the line of credit, pay the mortgage.

Fraser Smith: Okay, no. The test for deductibility of interest that the tax department applies is, "What did you do with the money that you borrowed?" And so when I did the cash flow example, the fellow did have a revenue house and, in that example, he was borrowing money to pay, essentially, the expenses of a business. And that qualifies to give him deductible interest on the money he borrowed. In the case that you're mentioning there, then in that case, they would look at it and say, "What did you do with the money you borrowed?" and you'd say, "Well, I paid down my first mortgage." And they'd say, "Well, we're sorry, but you can't deduct the interest for that because the purpose of the money was to pay down a loan which was not deductible," and that's your house mortgage. It's not deductible which is why we get started on this--

Alan Hinton: Got you.

Fraser Smith: -- venture in the first place.

Alan Hinton: I just wanted to ask that question.

Fraser Smith: Yeah, no, that's a good question. I tell you, I get confused every once in awhile, you know, it's like a circle and it depends where you jump into the circle. You can quickly make a mistake on that, too. So don't be embarrassed about that. It happens to us all.

Alan Hinton: Thanks.

Fraser Smith: Okay, Alan.

Operator: Our next question comes for Corine LaPointe. Please proceed with your question.

Corine LaPointe: Hello. What or how does one consider the managing of a mortgage per your manoeuvre where a rental property is already mortgaged. In other words, it's part of the existing house, in other words, there's a suite in a house so you have one mortgage.

Fraser Smith: Okay, is it one building and one mortgage, Corine?

Corine LaPointe: That's correct.

Fraser Smith: Okay, now in that case, then, you should already be in a position to be deducting a portion of your regular house mortgage. And let's say that the space that the rental area is taking up is 20 percent of your house square footage, say, then you're entitled already, without the manoeuvre, you're entitled already to deduct 20 percent of the interest expense of your house mortgage and 20 percent of your fire insurance and all that stuff. And if you have an accountant he'll be able to calculate that number for you. Even if you don't, you can do it yourself. You know, figure out what your square footage is and then what proportion of that is represented by the rental. And then just apply that against any expenses for the house. And you can enjoy that immediately, and if you haven't been doing it, then you can even go back and redo your tax for, I imagine, three years back. Is that true, Mark? Is it three years?

Mark Huber: I'm thinking ten.

Fraser Smith: I think it's three years, but Mark would be able to tell you. Now that takes care of that. Are you clear on that? You're okay to deduct that already?

Corine LaPointe: Yes.

Fraser Smith: Okay. Now, then, we're going to go after-- in that example it says that if 20 percent is already deductible, that still means that 80 percent of your house mortgage is not deductible. And so what you would do is work against that 80 percent number and to do that, you would separate it. It, you know, and so it's not something you can do in five minutes at the bank. What I would do if I were you is I'd sit with Mark and then between the two of you, you work it out and separate this thing out and you'll approach the bank. It probably takes a week, you know, to get through the niceties of this thing, but when you're finished, you will have an account, then, that is-- separates these things so that, therefore, a hundred percent of your house mortgage can be made deductible which is your objective, of course. So it's probably a little confusing to you but it's totally doable, I mean, that's not an uncommon happening. There's lots of people who have a renter in the house and we always made sure that, in the end, a hundred percent of their mortgage was made deductible, okay?

Corine LaPointe: Okay.

Fraser Smith: Okay, Corine.

Corine LaPointe: Thank you.

Fraser Smith: Thanks for asking.

Operator: Thank you. Our next question comes from Neil MacDonald. Please proceed with your question.

Fraser Smith: Hi, Neil.

Neil MacDonald: Hi. Just a question. We have a daughter who is in receipt of B.C. Benefits. Can-- is there any way we can apply these towards a mortgage where she could do the Smith Manoeuvre?

Fraser Smith: Would it be her own house?

Neil MacDonald: Probably not. It would probably be in the name, you know, she gets a rent allowance and would probably be in the name of Microboard that is set up for her.

Fraser Smith: I see.

Neil MacDonald: Or-- I don't know if she could own it or not. I’m not clear on that.

Fraser Smith: She may not be able to, eh?

Neil MacDonald: Yeah.

Fraser Smith: Well, they-- the benefits she’s receiving are income, are they taxable to her? Do you know if she’s paying tax on those benefits?

Neil MacDonald: No, they're not.

Fraser Smith: They're not taxable.

Neil MacDonald: No.

Fraser Smith: Well, I'm not an expert in this area and I will defer to Mark, but I would hazard a guess that it's just treated as income to her and then her income can support a mortgage, you see. If she has-- if she can obtain a mortgage on a house, then she can certainly set up the Smith Manoeuvre to do the other side of the equation that we've been talking about here. And so-- am I right, Mark? It's just income, in this case, is it not?

Mark Huber: That's right.

Fraser Smith: Yeah, I'm pretty sure that she could pull that off. Yeah.

Neil MacDonald: Okay.

Fraser Smith: I don't see why not. Sit with Mark, though, and have a go at it. It's a good question.

Neil MacDonald: All right. Thank you.

Fraser Smith: Thanks, Neil.

Operator: Thank you. Again, if you do have a question, please press "0, 1" now. And, currently, there are no questions in the queue.

Mark Huber: Okay, well thank you, operator. I think we should wind up the call. Fraser?

Fraser Smith: Yes, okay. Well, I-- nothing for me to do but say thanks to the people for taking the time out. Education, in the end, is the best and strongest tool that any Canadian can have when they're dealing with the tax department. So I hope you've seen that there' s a tool for you to be able to use here. It's an important one. And it's free on top of that. The only disadvantage is that you'll have to deal with Mark, and we wanted the best planner we could find in the world and he wasn't available today so Mark is filling in for him. But he's a good guy, and so I hope you people give him a call and sit with him and get her done. It's worth it.

Mark Huber: I just want to thank you, again, Fraser. And also, we would like to extend an invitation to all of those on the line today that have taken time out of their day to be educated, that we'd be delighted to sit down with each of them. If they want to fax back the last page of the handout where they could fill in some of their current mortgage information. And, again, we'd be delighted to give them a complimentary analysis to show them their current situation and the benefit of them starting to proceed with the Smith Manoeuvre.

Fraser Smith: Well, that's great. Thanks for having me on, Mark. Appreciate it. I've got another meeting to go do, Mark. Maybe I'll talk to you this afternoon.

Mark Huber: Sounds good.

Fraser Smith: Okay, my friend.

Mark Huber: Again, thanks to all and we will talk to everyone shortly.

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To Your Success,

Mark Huber, CFP

Resources Referenced On The Call

Get your copy of "The Smith Manoeuvre" here at:
http://smithman.net

The "Cash Flow Dam"
http://HowToBeSetForLife.com/Reports/CashFlowDam.pdf
"right click" and "save as" to your "desktop".

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"Mortgage Financing: Floating Your Way to Prosperity"
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"Mortgage Financing and Liability Allocation"
10 short pages summarizes 2 hypothetical clients – Linda Long and Shelly Short. Check it out to see who the winner is. You may be surprised.
http://HowToBeSetForLife.com/Milevsky/MortgageFinancing-4Answers.pdf

"Go with the Float? Fixed-rate mortgages offer piece of mind, but not much else." National Post Business magazine, April 2001
http://HowToBeSetForLife.com/Milevsky/GoWithTheFloat.pdf

"House Allocation"
http://HowToBeSetForLife.com/Milevsky/HouseAllocation.pdf

"Canadians' Debt Diversification: Why These Eggs Belong in One Basket"
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About the Author

Mark Huber is a proud Canadian living with his wife in scenic Richmond, British Columbia, Canada.

For over 22 years, Mark has worked in the financial services industry. The focus of Mark's financial planning advisory practice is focused exclusively to British Columbian (BC) Canada residents.

Mark's boutique planning practice works with a select group of clients who are all share a passionate vision for creating true wealth and living their dream lives.

Mark is author of "The UnCanadian Way" series of eBooks and audios. These powerful resources share innovative ideas and wealth building strategies to Canadians so that they will never again view their home, their mortgage, their debts, or their assets in the same way again.

Visit: http://HowToBeSetForLife.com/resources

Mark also maintains a premier financial planning site at:
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Mark Huber, CFP

SetForLife Financial Services
Richmond, British Columbia, Canada

Office Phone: Richmond (604) 207-9970
Office Fax: Richmond (604) 207-9971
Office Phone: Burnaby (604) 439-3341
Office Fax: Burnaby (604) 439-1900

E-Mail: mhuber@HowToBeSetForLife.com
Web Site: http://HowToBeSetForLife.com
Web Site: http://HowToGetRidOfYourMortgage.com

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-The End-