TAX MATTERS

A primer on the first-time home buyer credit, and some things to consider

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4 COMMENTS

Our oldest son, Win, is already thinking about real estate investing. “Dad, I want to buy a house near the university rather than paying rent to someone else,” he said a few weeks back. So, I made the trip to Waterloo to check out a place he was looking at. “What do you think?” he asked me. “Well, if the seller is willing to replace the roof and furnace, repave the driveway, build a deck, extend the family room out by 15 feet, and move the place to the other side of town, then I think the asking price is fair,” I replied.

It’s tough for young people to buy a home these days. The government is trying to make it more affordable by introducing the First-Time Home Buyer Incentive (FTHBI), which can reduce the monthly payments required when buying a home. The FTHBI was officially launched this week, on Sept. 2, so here’s a primer on how the plan works, and some things to consider before you apply for help under the program.

THE DETAILS

Under the FTHBI, the government will help you buy a home by providing up to 10 per cent of the purchase price. Basically, the amount provided is a mortgage on the property with no interest or ongoing payments required. The government will offer 5 per cent if you’re buying a resale home, and for newly constructed homes you can apply for either 5 per cent or 10 per cent. You’ll have to make repayment under the program when you sell the home, or after 25 years, whichever comes first – but you can choose to make repayment sooner.

This funding is called a “shared equity mortgage” so that the government will participate in any appreciation in value of your home, or declines in value. How does this work? Suppose you buy a home for, say, $400,000 and you receive a 10-per-cent incentive ($40,000) under the FTHBI program. If you later sell the home for, say, $500,000, you’ll have to repay 10 per cent of your selling price to the government – or $50,000 in this case.

To qualify, you have to be a first-time buyer, which means you have to meet one of the following tests: 1) You've never purchased a home before; 2) you've gone through a breakdown of a marriage or common-law partnership; or 3) in the past four years, you haven't occupied a home that you or your current spouse or common-law partner owned. So, you might qualify for the incentive if you're separated or divorced and don't otherwise meet the first-time home buyer criteria.

But there are more tests you've got to meet: Your qualifying income must be $120,000 annually or less, your total borrowing (your mortgage plus the incentive) is limited to four times your qualifying income, your minimum down payment must be 5 per cent (on the first $500,000 of property value; 10 per cent on the value above $500,000), and your total down payment must be under 20 per cent (so that the mortgage will be insured through either Canada Guaranty Mortgage Insurance Corp., Canada Mortgage and Housing Corp. or Genworth Canada).

THE EXAMPLE

Let's suppose you earn $100,000 annually, you want to buy a resale home, and you qualify as a first-time home buyer. The most expensive home you could afford under this program is about $420,000. If you make a down payment of 5 per cent ($21,000) and receive another 5 per cent FTHBI, then your mortgage would be $378,000 ($420,000 less $21,000 x 2). Your monthly mortgage payment would be $1,824 (assuming a 2.9-per-cent five-year fixed rate mortgage today – an average across institutions; check out ratehub.ca). Without the FTHBI, the mortgage would be $399,000 and your monthly payment would be $1,943 – higher by $119. The amounts factor in the mortgage insurance required.

THE BOTTOM LINE

Does the FTHBI make sense? There's a cost to the program, for sure. It all comes down to your expectation for real estate growth in the future. If your home appreciates by, say, 6 per cent compounded annually while you own it, that amount you receive from the government will cost you 6 per cent after taxes (that's what you'll be giving up). If prices don't rise much during your period of ownership, the cost to you for the FTHBI won't be as great.

Keep in mind, too, that if you make renovations that increase the value of your property, you'll be handing a portion of that increased value to the government later when you repay the FTHBI. Borrowing from parents or family to help in buying a home is likely a better option if you can swing that since you won't have to share the upside.

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