HBP or FHSA: Which One Should You Use?

While many people want to purchase a home, it's become a greater challenge in today's economic environment. Consumers are financially stretched by high inflation that's lifted the price of food, fuel and just about everything else. On top of that, central banks have raised interest rates to help control inflation, leading to soaring mortgage rates. Never mind that real estate valuations – while largely off their peak – remain high, especially in large urban centres. What's a prospective homebuyer to do?

In addition to sensible actions like watching your spending and trying to put away more of your earnings, the federal government also helps Canadians pursue home ownership via two targeted programs: the Home Buyers' Plan (HBP) and Tax-Free First Home Savings Account (FHSA).

How the HBP works

This plan lets you withdraw, on a tax-free basis, up to $35,000 from your Registered Retirement Savings Plan (RRSP) to purchase your first home. Essentially, it's an interest-free loan from your own RRSP to help you buy a home. You're allowed to withdraw funds from more than one RRSP, to a cumulative total of $35,000, provided you're the owner of each account. The institution(s) that issued your RRSP(s) won't withhold tax on the money you withdraw. You should also note that certain RRSPs, such as locked-in or group RRSPs, may not qualify for the HBP.

You have up to 15 years to pay these funds back to your RRSP, beginning in the calendar year after the withdrawal. Repayment is based on a prescribed schedule with a minimum annual repayment of 1/15th the original withdrawn amount. Note, you may repay more than the minimum in a given year, or repay the entire amount at any time prior to the end of this 15-year period. If you fail to repay the full amount within the allotted time, your outstanding balance is considered taxable income.

How the FHSA works

This plan was introduced in the 2022 Federal Budget, and now that the legal and administrative details have been addressed, financial institutions are rolling it out. The FHSA is a registered account for Canadians aged 18+ who haven't owned a home ever or, at a minimum, in the past four calendar years. It allows eligible Canadians to contribute up to $8,000 annually on a tax-deductible basis, to a lifetime limit of $40,000. If you contribute less than the maximum in a given year, the unused contribution room (up to $8,000) may be carried forward to the following year.

When you withdraw funds to buy a home, this amount is not taxable (including any income earned in the account). If you don't withdraw all your FHSA funds to buy a home within 15 years, you must close the account. You can transfer the remaining assets, tax free, to an RRSP or RRIF; otherwise, withdrawal of residual FHSA funds will be taxable. As with many registered accounts, you may invest in various types of securities in your FHSA, including mutual funds and ETFs. Your advisor can help determine which securities best suit your time horizon, risk tolerance and financial objectives.

How do you decide?

While the HBP and FHSA may have their own features and distinct rules, both plans can help accelerate the home ownership process. An HBP is valuable if you don't have much cash available, since you're withdrawing from your established and funded RRSP. An FHSA is valuable if you can contribute a significant amount of cash, since it'll lower your taxable income and withdrawals are tax free. The good news is, you don't need to decide. If you wish (and have money readily available), you may use both the HBP and FHSA to assist with funding the purchase of a first home.