THE GLOBE AND MAIL

RRSPS

Should I pay down my mortgage or save for retirement?

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The Globe and Mail
PublishedThursday, Feb. 14 2013, 7:27 PM EST
Last updatedThursday, Feb. 14 2013, 8:40 PM EST

Should you focus on paying down your mortgage, or maximize your RRSP contributions?

With the March 1 registered retirement savings plan contribution deadline approaching, it's a question vexing many Canadians. To help us explore the pros and cons of each approach, The Globe and Mail asked two certified general accountants to weigh in.

Emily Larimer, a sole proprietor in Toronto, advocates paying down the mortgage before contributing to an RRSP. She believes that people with the financial flexibility to do so should accelerate their mortgage payments to become debt-free as soon as possible.

Ali Jaffer, president of AR Jaffer Professional Corp. in Mississauga, believes that most people will be better off in the long run by maximizing RRSP contributions now, while gradually paying down the mortgage according to a regular amortization schedule.

We've edited their comments for clarity and space.

John Heinzl: Emily, let's start with you. Why are you such a big fan of paying off the mortgage early?

Emily Larimer: Your biggest asset is your house. And you want to pay off that loan because you want to eventually pay yourself rather than the bank. And you're building equity which you can eventually use to do other things.

John: What about the emotional benefits?

Emily: They're tremendous. You don't have to check the bank account. I've been self-employed for a long time and I don't have that monthly mortgage fee.

John: When you make a mortgage payment, you're effectively earning a guaranteed after-tax return equivalent to the mortgage's interest rate. But aren't you giving up potentially bigger returns in the stock market?

Emily: Well, I prefer known things rather than unknown things. The higher the risk the greater the reward, yes. But there are so many risks in the world it makes sense to take some of the risk out.

John: Ali, I'm guessing you disagree.

Ali Jaffer: Yes, and there are a few reasons for that. With an RRSP you're taking advantage of the tax-free compounding. The stock market has produced a much higher return than you're saving on mortgage rates of 2 to 3 per cent.

If you go back to 1930, adjusted for inflation the S&P 500 has been performing in the 8- to 9 -per-cent range. In the last 10 years it hasn't fared as well. But you have to look at the long run, especially for most investors who have, say, a 25-year mortgage and a 25- or 35-year horizon for retirement.

Emily: The stock market can be extreme at times, especially in '08 and '09. So for any individual at any point in time, it's very hard to know what the stock market will do.

Ali: But if you invest over a long period you're taking advantage of dollar cost averaging and the fact that money will double every eight to 10 years with an 8- to 10-per-cent rate of return.

John: Ali, what are some other factors to consider?

Ali: Most people who can afford a mortgage these days are in a higher tax bracket and can take advantage of RRSPs to lower their taxes. Also, most newcomers to the housing market are usually younger and there is no guarantee that they'll be getting good pensions in the future, so they have to start building that now for themselves.

Emily: I would agree that you need to save for retirement. But once you pay the mortgage down you can contribute more to your RRSP. You don't lose that contribution room.

John: The financial industry talks a lot about the benefits of investing in RRSPs, but you don't hear a lot of financial types talking about the benefits of paying down the mortgage early. Why not?

Emily: Because the banks like to get the interest from mortgages. And financial advisers make money from commissions and fees on your assets.

John: And if you're paying down your mortgage, they get less of your assets to manage, so they make less money, right? What about people who can't commit one way or the other. Is there a middle way?

Ali: Yes, when you get the RRSP refund you can choose what to do with it. You can reinvest it or pay down the mortgage, so you could kill two birds with one stone.

John: You've both made some great arguments.

If you pay down the mortgage, you get a guaranteed return and the emotional and financial benefits of being mortgage-free. But if you focus on RRSPs first, you may well be further ahead in the long run.

Thanks to both of you for joining us and helping Canadians work through this financial conundrum.