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Smart investors skip RRSPs to pay down mortgage now

Plenty of time to play catch-up

It s RRSP season, and once again, Canadian homeowners are being bombarded with advertisements and advice urging them to invest every spare dollar into Registered Retirement Savings Plans annually until retirement.

For years, however, I have always advised clients - particularly young clients - exactly the opposite: forget the RRSPs and instead pay down the mortgage on their homes as fast as possible.

After an extensive review of the electronic hype available on almost 200 Canadian web sites this week, I have concluded that most of the available advice is incomplete or one-sided, and some of it is actually wrong.

Most of the internet sites discussing the question of RRSP contributions vs. mortgage paydown are written or sponsored by organizations or investment advisers who earn their income on commissions from RRSP contributions. Nobody earns a fee when a homeowner pays down his or her mortgage.

As a result, it is good to take the advice from some sources with a grain or two of salt.

I found one of the best unbiased pieces of advice on the web site of investment guru Gordon Pape, *www.gordonpape.com*. The question and answer portion of the site asks, "Is it better to pay down your mortgage while the interest rates are low or is it wiser to take the extra cash and put it into mutuals or some other investment vehicle?"

The answer, which overflows with common sense, is, "Consider it in terms of after-tax return. Say you re paying an interest rate of seven per cent on your mortgage. If your marginal tax rate is 40 per cent, you have to earn more than 11.7 per cent a year on your investments, every year, to come out ahead."

"If you use a lower marginal rate, say 30 per cent," it continues, "and invest in securities that pay mainly dividends and capital gains, you still have to realize better than 10 per cent annually. Perhaps you can achieve that. But the mortgage paydown is a sure thing."

Ross Taylor Financial *(www.rosstaylorfinancial.com),* comes to the same conclusion: "If your total taxable income from all sources is less than $30,000 and you will have mortgage payments for more than five years, you would be better off to pay down your mortgage instead of contributing to an RRSP just yet."

I think the answer is the same with incomes over $30,000 as well.

A number of web sites, like that of the BMO Investment Centre, state that excess cash should be used to invest in an RRSP and then the tax refund can be used to pay down the mortgage.

The flaw in this argument is that if it makes sense to use just the tax refund to reduce the mortgage, why not take all of the excess cash, pay the tax on it, forget the RRSP, and use *all* of what s left over to pay down the mortgage? In this way, the mortgage can be paid down much faster.

Other Web sites provide "mortgage calculators" which project whether the homeowner would be better off at age 65 if the mortgage is paid off before an RRSP is started.

These so-called calculators conveniently ignore the fact that every cent in the RRSP is taxed when it is withdrawn at and after age 65. And there is no guarantee that Canadian tax rates won t be higher at retirement than they are now.

Other Web sites give examples of how a homeowner would be better off contributing to an RRSP instead of paying off her mortgage. The worst example I saw showed an accumulated RRSP value of $3.5 million at age 65, but assumed the investment plan would yield an incredible 12 per cent annually for 35 years - an unlikely scenario.

Some advisors, like *www.investorsgroup.com,* say that there is no clear-cut answer to the mortgage vs. RRSP debate. Among the factors to take into account, they suggest, are your age, your tax rate, your mortgage rate, your general financial health and your pension plan.

My recommendation is to obtain independent - truly independent - financial advice. Paying off a mortgage and building up a nest egg are both important components of a good financial plan.

But no mathematical formula, and no investment advisor, can measure the peace of mind a homeowner will experience in burning the mortgage by age 40. That still leaves a full 25 years before retirement to play catch-up on RRSP contributions or raise the lifestyle a notch.

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