

Wealth Planning

Should I pay down my mortgage or invest in my RRSP?

This question is a common one, especially when extra cash becomes available and you need to make decisions about how to best allocate your dollars for long term benefit. There is no easy answer and the decision can be a very personal one.

Here are a few tips that can help you make the right choice for your personal circumstances.

Pay off all non-tax deductible high interest rate debt first, such as credit card balances or consumer loans. Then consider using the extra cash for mortgage pre-payment or RRSP contributions.

If you have an uneasy relationship with debt, then eliminating all your debt including your mortgage should be your priority. In other words, if you cannot sleep at night because you worry about your debt load, pay it off as fast as possible. After the debt is brought to a level at which you feel comfortable, then your priorities can more comfortably shift to building your savings. After all, paying off your mortgage is the least risky of all strategies and for highly risk-averse investors; this may be the best choice.

When deciding whether to put extra cash towards your mortgage or towards your RRSP take into consideration the rate of interest paid on the mortgage versus the expected rate of return earned on your RRSP. If you expect to pay a consistently higher rate of return on your mortgage than you expect to earn on your RRSP then it's likely a good strategy to pay down the mortgage as fast as possible. You can then shift your strategy to savings when the debt is paid off. This is a good rule of thumb in many cases.

Rates on most mortgage debt in recent years are relatively low. As a result, many investors are looking for a way to lower their debt load, but not exclusively. They also want to take advantage of tax-efficient investing in their RRSP to grow their nest egg.

Many investors use a common two-step strategy for using extra cash which can simultaneously achieve the goal of paying down their mortgage faster while also building their RRSP.

1. The first step in the strategy is to invest the extra available cash in the RRSP.
2. The second step in the strategy is to use the tax refund generated by the extra RRSP contribution to pay down the principle of the mortgage.

In certain situations, this strategy can result in the maximum financial benefit over the long term.

The term and interest rate on the mortgage along with the expected return on your RRSP savings are all relevant when making the decision about where to allocate extra cash. Each situation is different. In order to see how all the variables interact, it's often useful to use a financial calculator specifically designed to assess the impact of various strategies on your long-term financial picture. These types of calculators are available on the internet and through your financial advisor.

Talk to your Dundee Financial Advisor when extra cash becomes available. Together you can determine the best way to generate maximum benefit from your dollars in a way that suits your personal situation.

At Dundee Wealth Management, we believe that having a financial plan forms the foundation necessary to grow, protect and transfer wealth from one generation to the next. We are committed to provide information on a variety of financial planning topics so our clients are able to make informed decisions.

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