Pay Down Debt or Retire in Comfort?

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Increasingly consumers in major Canadian cities such as Calgary, Edmonton, Vancouver or Toronto, are faced with a dilemma of how to best manage their cash flow in the face of record mortgage and consumer debt.

A February poll by CIBC asked Canadians whether, if they had extra funds they would contribute to an RRSP or pay down debt. Some 72% of respondents favoured debt repayment over retirement savings. The primary reason cited for favouring debt repayment was to be debt free. This emotional response far outweighed other practical reasons for being debt free such as a concern about possibly rising interest rates or that their current debt levels were too high for comfort.

The risk with this approach is that it may be short sighted. Getting out of debt too fast now may actually negatively impact our long-term retirement savings. Of course high interest consumer debt such as credit cards at 27% or so are still are high priority for getting paid down.

But mortgage interest rates are at their lowest point in over 60 years according to the Bank of Canada. Five year rates as of April can be had for under 3% and a ten-year fixed residential rate is around 4%. Thus it may make sense to leave your mortgage debt as is, assuming it is cash flow affordable, and contribute to an RRSP\TFSA if you can get a better rate of return on your investments over the long term.

An RRSP offers you immediate tax savings, which are more attractive the higher your marginal tax rate while TFSAs offer no taxes payable on the growth or income in the accumulating fund. If you were to ever get into cash flow problems in the future, you still have the option of taking the money from the TFSA and possibly (but not ideal) from RRSP to pay down your mortgage debt and save your home ownership interest.

But the best reason for investing in your retirement savings programs is to help build your assets. As discussed in the Financial Planning Simplified series last year, the objective for most Canadians is to build a bag of money (assets) from which they will draw an income to support their desired or ideal lifestyle once they stop working.

If your focus is on debt reduction and not equally or more so on asset building, then the risk is you will arrive in your 50’s with little or no retirement savings (or other assets besides a house) and with little time, maybe 10 – 15 years, in which to save money for retirement and to put the power of compound growth to work for you and your family.

The real magic from compound growth starts to happen around the fifth doubling of your money and that takes time. One dollar becomes 2 then 4 then 8 then 16 then 32 then 64. Over what time frame this growth happens is a function of what return on investment you earn and your ability to stay the course, which is why returns matter! Playing it safe by investing in GICs and other perceived “safe” investments can cause you to miss out on potentially huge growth on your money during your 80 – 100 year lifetime!

Call us today to review your current family debts and asset accumulation strategies to see how we can help your family markedly improve their long-term financial prospects!

Do you have questions about your retirement strategies?

Contact our office today ! [1]

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