Anna and Andrew consider paying down their mortgage versus contributing to their RRSP. RBC® helps them make the right choice.

Andrew and Anna just moved up to their 'forever' home. While they enjoy the larger space and neighbourhood, they're a bit nervous about what the new mortgage and household expenses will mean for their retirement savings.

Their RBC Mortgage Specialist introduced Anna and Andrew to Susan, an RBC Financial Planner. Susan listened as Anna and Andrew explained that they have $750 per month available to save for their future, and their question is:

Are they better off to pay down their mortgage or to contribute to RRSPs?

Anna and Andrew's situation

- Both are 38 years old
- Mortgage amount: $396,000 with 25 years left to pay off
- Mortgage rate: 3.5%
- Both are in the top tax bracket – RRSP contributions will therefore result in tax savings
- Projected annual return on RRSP investments: 5%

Susan suggested comparing two strategies

Strategy 1	Strategy 2
Use the $750/month to pay down the mortgage	Contribute the $750/month to an RRSP
Once the mortgage is paid off, use the $750 – plus the amount previously used to make mortgage payments – to build up their RRSPs	Use the income tax savings to make lump sum payments on their mortgage
Once the RRSP limits are reached, reinvest the income tax savings first in a TFSA and once that is maximized, to a non-registered account	Once the mortgage is repaid, put the amount of the mortgage payments plus the income tax savings first in a TFSA and once that is maximized to a non-registered account

So which strategy will build their net worth faster?

After 15 years...
Strategy 1 increases their net worth by **$544,392**
Strategy 2 increases their net worth by **$645,641**
Difference = $101,249 in favour of Strategy 2

The change in net worth was calculated by adding:

- RRSP and non-registered contributions
- Growth of RRSP and non-registered investments
- Price appreciation of house (assumed to be 2% per year)
- Increase in home equity from mortgage payments

Key considerations

Both strategies will pay the mortgage off faster

- By focusing on the mortgage alone, the debt is repaid in full after 16 years
- By focusing on the RRSP and using tax refunds to make lump sum payments on the mortgage, the mortgage is paid off in 20 years – five less than the original 25 year payment schedule

The rate differential matters

- In this example, there is a meaningful difference between the 3.5% rate on the mortgage and the 5% earned in the RRSP
- If the interest rate on the mortgage was greater than what is earned through the RRSP, the numbers may favour focusing on the mortgage
- If the projected growth in the RRSP was less than the mortgage rate, the result may favour prepaying the mortgage

Tax bracket

If Anna and Andrew were in a lower tax bracket, the RRSP refund would be lower, and the outcome would be different.

Susan reminded Andrew and Anna that financial projections are based on assumptions, so it's a good idea to review those assumptions from time to time. Tax brackets, mortgage rates, real estate prices and investment returns can all change, as can income level or household expenses.

What would you do?

Sometimes, the numbers tell you one thing, but your heart says another.

For many Canadians, debt free home ownership is an important goal. No matter what the numbers show, it may be a higher priority than future retirement savings. But by taking the time to calculate the potential impact to your future net worth, you can make an informed decision.

This is one example of how personalized financial planning can help you get where you want to be. An RBC Financial Planner will work with you to develop the strategy that is right for you, based on your specific situation. Starting with understanding what matters most to you, they will provide the financial analysis to help you make decisions tailored to your goals, priorities and resources.

Prior to implementing any strategies contained in this article, individuals should consult with a qualified tax advisor, accountant, legal professional or other professional to discuss the implications specific to their situation. Please speak with your advisor.

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