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**Have a Big Mortgage? Other Debts?  
Perhaps it's Time to Stop Contributing to Your RRSP or TFSA**

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The age-old financial dilemma of whether you should use any excess cash to contribute to your RRSP or pay-down your mortgage has gained renewed currency in the aftermath of the financial crises. Canadians are learning to save more, invest more conservatively and de-risk their retirement account. So, despite what your personal conclusion might have been last time you thought about the smack-down between RRSPs vs. Mortgages, the economic equation has recently tilted in favor of paying down debts vs. building up assets, but only for those of you with low tolerance for any investment risk.

Allow me to explain.

As you probably noticed, despite recent moves by Mark Carney and the Bank of Canada to nudge the numbers upward, the interest rate being earned from GICs, term deposits and Government bonds remains pathetically low. For those risk-averse savers who abhor the volatility of the stock market, money is earning 3% -- if they are willing to lock-in for a few years -- and less than 1% on demand deposits and savings accounts. Hey. Did you ever hear of the rule of 72? Guess how long it takes money to double if your retirement's nest egg is earning 1% per year? Yes. You guessed it. 72 years.

I have a better idea.

Do the math. If you are paying 6%, 5% or even 4% on your mortgage – which is on the liability side of your personal balance sheet – but your financial assets are (only) earning 1%, 2% or 3%, then you are effectively destroying wealth. It's the debt equivalent of constantly buying high and then selling low in the stock market. Once you think about for just a few seconds, you realize it's dumb.

Here is how to think about the tradeoff between paying down your mortgage versus saving in your RRSP or TFSA. Every dollar you don't contribute to your investment portfolio will earn the mortgage rate you are not paying on that dollar. If your mortgage is costing you 5%, then every dollar you don't invest but instead use the money to pay-down debt will earn the said 5%. If the debt clock is ticking at 10% or 15% like many credit cards, the argument for raiding your retirement accounts to eliminate the debt is even stronger.

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Of course, if your investments – RRSPs and the like – are invested aggressively under the hope and expectation that they will earn more than mortgage rate you are paying or current bond yields, then you can justify not paying down your mortgage. After all, borrowing at 5% makes sense if you expect to earn much more. However, you have to be able to look yourself in the mirror and say: “Yes, I think my assets will earn more than my liabilities are costing me.” Remember, even the most delusionary deflationary pundit doesn’t forecast a 5% gain on your Government Bond, or GIC or cash that is only earning 3% per year interest.

Just to make sure I am crystal clear here, I personally have a mortgage and will not be paying down debt. Instead, I plan to contribute the maximum to my RRSP this year – but it is all going into the stock market. Yup. I can handle the risk, but I fully understand if you can’t. Indeed, if that is your case, there is nothing wrong with investing your precious nest egg in bonds. But my main point is that I have an even better bond for you, it’s paying down your own mortgage and all the other high-interest debt you are carrying.

Don’t take my word for this either. A recent article by two economists at the University of California, Berkley made the same point, albeit with reference to a U.S. audience. They examined over 15,000 household financial records and determined that over a quarter of those households should completely abandon equity market participation or stock ownership because of the high interest rates they are paying on their large portfolio of debts. To quote their published words in a scholarly journal called the *Review of Financial Studies*, “...households with high interest debt have a reduced benefit to equity participation and in many cases should not own any stocks...repayment of outstanding debt almost always yields a higher rate of return than many of the safe (investment) assets.” This might be quite obvious to some – pay down your credit card debts, duh! -- but the fact 25% of their sample isn’t doing it right is downright shocking. Yet I suspect the percentages of sub-optimal behaviors might even be higher in Canada.

Remember now, mortgage interest is not tax-deductable (compared to the U.S.) which means that your Canadian debt is costing you even more compared to the U.S. consumer referenced above. The 5% you are paying on your mortgage is 5% after taxes. The higher your tax bracket the more painful is the lack of interest deductibility. Many Canadians might be better-off forgoing the immediate tax deduction from the RRSP contribution – which will eventually have to be paid back – and instead pay down their high interest debt. An even stronger case can be made against TFSA contribution, again, if your debts are ticking at high rates but your assets are growing (or even shrinking) at low rates.

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Ok. Here is the bottom line. It's time to look at both sides of your personal balance sheet at the same time! Add-up all your debts compare the interest cost of all your liabilities against the interest you will be earning on your retirement investments, based on your current asset allocation mix between stocks and bonds. If the former is greater than the latter, it's time to pay down some debt and forgo the investment plan contribution. Oddly enough, not contributing to your RRSP or TFSA might make you wealthier in the long run.

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