Pay off Your Mortgage or Save More in Your RRSP: Which Will Make You Wealthier?

Description

It’s an argument that’s as old as the hills: should you pay off the mortgage, or save for retirement?

Those on “team retirement” say you should do both. Make the minimum payments on your mortgage *and* invest in your RRSP. By the rule of compound interest, you can earn substantially more by investing now, rather than waiting.

Those on “team mortgage” say you should pay off the mortgage first. After all, until you free up your income from debt, you’re technically not debt-free. And, once you do pay off the mortgage, you can throw gobs of cash in your RRSP. You won’t be paying interest on your mortgage, either, which can help you save money in the long run.

So, which is it? Save money on mortgage interest by paying it off now? Or earn money on compound interest by investing today?

The argument for paying off your mortgage

In general, it’s more advantageous to pay off your mortgage first, when your mortgage rate is higher than your RRSP’s return on investment.

If your mortgage rate is, say, 2.5%, and your RRSP is only earning 2%, then you’re paying more in mortgage interest than earning on investments. In this case, it would make more sense to pay down your mortgage first, then throw everything into your RRSP. You’ll sacrifice valuable time, sure, but at the end of the day, you’ll end up saving money on interest.

But, to me, this is simply laughable. Unless you have all your money in a GIC in your RRSP, or you’re a really, really bad day trader, your investments can easily earn more than the historically low mortgage rates we’re seeing now. The only time I would run the numbers is if your mortgage rate is relatively high. For those with bad credit, for instance, it might make more sense to unburden your income from high mortgage rates.

The argument for saving more in your RRSP

Again, in general, it's better to pay the minimum on your mortgage and save in your RRSP, when your return on **i**nvestment is higher than your mortgage rate.

That's not a steep challenge. While you can't guarantee that the market will work in your favour, it's very likely that the average return on investment (ROI) on your investments can outpace your mortgage rate. "Average" is the keyword there. Some years, you may see a lower rate of return on your investments, perhaps even lower than your mortgage rate. But as long as the overall ROI is higher than what you're paying in mortgage interest, it makes far more sense to invest money now than wait until you've paid off your mortgage.

Can you pay off your mortgage early *and* save for retirement?

It's certainly possible. If your annual income suddenly jumps (for example, you got a raise at work, or you inherited money), it may make sense to pay off your mortgage, while investing the same amount in your RRSP.

Just do the math first. If you have a solid investment portfolio — one that is constantly earning you around 8% to 10% per year, then you might be better off throwing more money into your investments and paying the minimum on your mortgage. You could earn more money in the long run by investing more now, even if you're still paying money on mortgage interest.

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