Manulife Investments

WealthStyles

Catch – 22 Mortgage vs. RRSP

Each year, as the annual RRSP deadline looms, many Canadians face a dilemma: should they pay down their mortgage or increase their RRSP contributions?

The decision may seem like a catch-22. If you pay down your mortgage, you'll be debt-free sooner but your future retirement income may suffer. If you contribute to your RRSP, you'll enjoy the benefits of tax-deferred, compound investment growth but you'll be no closer to owning your home. What if there was a way to achieve both goals?

In the past, many Canadians have tended towards contributing to their RRSP rather than paying down their mortgage. And, to be fair, there is something more satisfying about seeing an asset grow than watching a liability shrink. In fact, this bias was borne out in a recent Maritz:Thompson-Lightstone survey, in which 66 per cent of Canadians said they would rather put their money toward something else than pay down their mortgage, despite the fact that 82 per cent think paying down their mortgage is important.

YOU REALLY CAN DO BOTH

More and more Canadians are discovering a simple, efficient way of paying down their mortgage AND contributing to their RRSP through the use of "flexible mortgage accounts." First developed in Australia, these accounts are designed to significantly reduce the total amount of interest paid over the life of a mortgage by lowering monthly interest costs.

HOW IT WORKS

The flexible mortgage account takes your chequing account and rolls it into your mortgage. In essence, your mortgage becomes your chequing account. Now, every time you get paid, instead of having your money sit idly in a chequing account earning you low-to-no interest, it

is immediately applied against the principal of your mortgage and pays it down. Every day that you have even a dollar of income in your account, you have less debt than you had before, so you're paying less interest.

Next, you take any other debts you may have that are at a higher interest rate than prime (e.g. credit cards, personal loans, lines of credit, etc.) and add them to your mortgage. Now, instead of servicing debts at five, seven or eighteen per cent, all of your debts are consolidated at prime. Immediately, extra cash that used to go towards interest payments is freed up to pay down your mortgage more quickly, possibly years sooner and without any penny-pinching or budget-tightening.

You also add any idle savings you have to the account. The benefit is two-fold: First, you will almost certainly "save" more interest by reducing your mortgage with that money than you would be able to "earn" with it in short-term investments.

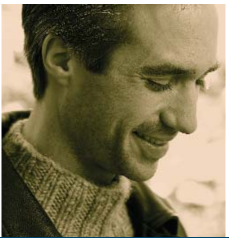
Second, your money is just as accessible as it was in your savings account (in some cases even more accessible) because you can take the money back out if you ever need it. Meanwhile, it's working to pay down your mortgage.

BUT HOW WILL A FLEXIBLE MORTGAGE ACCOUNT HELP YOU CONTRIBUTE TO YOUR RRSP?

First, by combining all of your debts and short-term savings into a single account, you can free-up cash — sometimes hundreds of dollars a month. For example, by moving $5,000 from credit cards to your flexible mortgage account at prime[1], you can reduce an annual interest payment of $900 to a mere $213 (assuming the debt isn't being paid down). Those savings can be applied to a monthly RRSP commitment.

Second, if the additional cash you've freed up isn't enough to maximize your RRSP contribution, you can "borrow" the money out of your flexible account, assuming you stay within your overall borrowing limit. Then, as your tax refund and income flow back into the account, your principal is automatically paid down once again. Of course, if you need the cash for something else down the line, you have the flexibility to take it out again at any time.

Using a flexible mortgage account this way can help you pay down your mortgage more quickly and contribute to your RRSP. That's one less decision you'll have to make and it will put you one step closer to retiring both your mortgage and yourself.





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Not all Canadians struggle with the "mortgage vs. RRSP" dilemma. For those who don't have a mortgage, the question may simply be "where will I find the money to contribute to my RRSP?" While it's true that it's better to contribute to an RRSP sooner rather than later, it's equally true that it's better to contribute late than not at all. Translation? It's never too late to contribute. If you're nearing the RRSP deadline and don't have enough cash on hand to make a meaningful RRSP contribution, a low-interest RRSP loan[2] can be an excellent alternative.

An RRSP loan enables you to make a large lump-sum contribution to your RRSP before the deadline and take advantage of tax savings on the previous year's income. It also allows a larger amount to compound within your RRSP for a longer period of time. This could mean more money available at retirement.

Don't let a lack of immediate cash derail your RRSP savings. An RRSP loan is a quick, easy and cost-effective way to help your retirement savings continue to grow.

1 The Manulife Bank prime lending rate is 4.25 per cent as at October 25, 2004. This rate is variable and subject to change.

2 Borrowing to invest in an RRSP may not be suitable for everyone. You will need the financial means to meet your loan obligations. In addition, investments held in an RRSP may fluctuate in value. You should be aware that regardless of their performance or value of any investments held in your RRSP, you will be required to meet your loan obligations in full. Talk to your financial advisor to find out more about the advantages and obligations of borrowing to invest.

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