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Can Thomas save for retirement while also paying a new mortgage?

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Last November, Thomas took the plunge and bought a condo in Toronto valued at about $660,000. He's 40, single with no dependants, and has lived in Canada since 2015. Before he bought the condo, Thomas was able to save $2,000 a month to his tax-free savings account and $700 a month to his personal RRSP. He earns $100,000 a year in a middle-management job. Now his TFSA is empty and his RRSP has shrunk.

His challenge is "how to plan for my retirement since a big chunk of my paycheque goes to paying my mortgage," Thomas writes in an e-mail. He's part of a group RRSP at work to which both he and his employer contribute 4 per cent of his salary each year.

Thomas plans to retire at the age of 65 with a spending goal of $36,000 a year after tax. He wonders if $1.7-million in savings, not including his home, "will be enough to take me through my retirement days from age 65 to 90" – and if he can actually save that much. "I'm living frugally right now," Thomas writes, "but I do want a little bit of breathing room to do my hobbies when I retire."

We asked Ian Calvert, vice-president and principal at HighView Financial Group in Toronto, to look at Thomas's situation.

WHAT THE EXPERT SAYS

After income and payroll taxes, Thomas was saving about half of his take-home salary, Mr. Calvert says. "Now a large percentage of his after-tax income goes to servicing his mortgage." Thomas is still saving through the equity he is building in his condo, but real estate ownership is proving challenging to his retirement savings plan.

"Thomas is not alone," the planner says. Recent house price appreciation has buyers taking on mortgage debt so high that it can prevent them from accumulating enough retirement savings.

"In Thomas's situation, his mortgage payments alone represent about 47 per cent of his take-home income," Mr. Calvert says. "A debt service ratio that high will certainly make meeting his retirement asset goals a challenge."

In the past, many Canadians without pension plans or significant retirement savings were saved by the enormous tax-free appreciation of their primary residence, the planner says. "If you were an owner of real estate, your house became your retirement security." With current real estate prices, relying mainly on the appreciation of your house to fund your retirement will be a riskier assumption, he says.

In addition to his real estate, Thomas's goal is to retire with $1.7-million in savings to supplement his government benefits. "Having an employer-matched group RRSP is a great asset to have," Mr. Calvert says, but it alone will not provide the level of the savings to meet Thomas's goal. The market value of his group RRSP is about $25,000. Assuming Thomas's income grows by 2 per cent a year, and his employer matching continues until 65, he should have about $565,000 by 65, the planner says. "This is a great start, but still leaves a sizable gap of $1,135,000."

To meet his goal, Thomas will have to accumulate savings in both his personal RRSP and his TFSA. "The RRSP contributions will be a valuable tax deduction each year, but the TFSA should certainly not be ignored," Mr. Calvert says. "Having a sizable tax-free investment account to use in your retirement years is one of the most important pillars of a comprehensive retirement plan." Thomas should use his TFSA for long-term investing rather than as a savings account, the planner says.

If Thomas is able to save $1,000 a month, $500 to his TFSA and $500 to his RRSP, he will still fall well short of his retirement goal, Mr. Calvert says. Assuming a 5-per-cent rate of return on his investment portfolio and group RRSP, he would have amassed a portfolio of $1,150,000 at 65.

"Even maxing both his TFSA at $6,000 a year and his RRSP at $10,000 [because of the pension adjustment] – which would be a big challenge given his already modest lifestyle – would bring his total financial assets to $1,320,000 at age 65," the planner says. "Thomas has put himself in a position where servicing the debt on his home will undoubtedly jeopardize his ability to save enough to meet his retirement goal."

Another significant risk to his retirement savings plan will be maintaining his targeted savings rate when his mortgage term renews at a potentially higher interest rate.

Thomas does have another asset that will help – an overseas property worth about $110,000 that he is planning on selling to pay down his mortgage. Although this is a good idea, he could also consider adding the $110,000 to his retirement savings, the planner says.

"Adding $110,000 to his portfolio now and investing prudently can make a significant impact over 25 years," Mr. Calvert says. If this $110,000 was able to earn 5 per cent compounded annually, it would be $367,000 by age 65. This, plus the scenario of saving $1,000 a month, would put his total retirement savings at $1,517,000.

So can Thomas meet his goal?

Adjusting for inflation, Thomas's spending goal of $36,000 will be about $60,000 by 2047, when he is 66 and in his first full year of retirement. That assumes an inflation rate of 2 per cent. "If Thomas continues to participate in his group RRSP and saves $12,000 a year split between his personal RRSP and TFSA, this should be an achievable goal," the planner says. By 2047, his Canada Pension Plan is expected to be about $17,600 a year and his Old Age Security $9,600. Between his group and personal RRSPs, Thomas would need to withdraw about $40,800 a year to fund the $60,000 of expenses plus $8,000 in personal income taxes – "a fairly healthy withdrawal rate of 5 per cent," Mr. Calvert says.

He suggests Thomas draw up a comprehensive investment policy statement that captures his investment goals, and an asset allocation that balances his goals with his appetite for risk. "An IPS would allow Thomas to stay disciplined, stay on track and continue to build his portfolio to meet his retirement savings goal," the planner says.

CLIENT SITUATION

The person: Thomas, 40.

The problem: Can he pay off his mortgage and save enough money to retire with $36,000 a year after tax?

The plan: Continue to live frugally and save $1,000 a month through his TFSA and personal RRSP. Sell the foreign property and either pay down his mortgage or invest with a target rate of return of 5 per cent. Draw up an investment policy statement to keep himself on track.

The reward: A clear appreciation of the challenges ahead.

Monthly net income: $5,580.

Assets: Bank account $28,000 (emergency fund, travel); TFSA zero; personal RRSP $3,900; group RRSP $24,700; condo $661,000; overseas property $110,000. Total: $827,600

Monthly outlays: Mortgage payment $2,650; property tax $220; home insurance $40; electricity $60; condo fees $550; transit $120; groceries $240; discretionary $30; personal care $30; dining out $420; subscriptions $95; communications $90. Total: $4,545.

Liabilities: Mortgage $635,000 at 1.74 per cent ($1,325 biweekly, accelerated) with 22 years to run.

Ian Calvert is a Vice President & Principal at HighView Financial Group.