FP Answers: Can I retire in 15 years even though I'm still paying off my mortgage?

There are lifestyle choices you need to make when deciding what to prioritize going forward

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Publishing date:
Jan 28, 2022 • January 28, 2022 • 4 minute read

In making a choice between paying down a mortgage that has a lower rate of interest or investing the money at a higher rate of return, it may seem logical to go with the investment option. PHOTO BY GETTY IMAGES/ISTOCKPHOTO FILES

By Julie Cazzin with Janet Gray

Q: I'm 45 years old, self-employed and earn $125,000 annually. I have $55,000 in a tax-free savings account (TFSA), $250,000 in a registered retirement savings plan (RRSP) and $400,000 in a non-registered investment account. I contribute roughly $3,000 a month total to these accounts for retirement. My two-bedroom condo in Hamilton is valued at $500,000 and I have a mortgage of $222,000 remaining. I have no other debts. Can I retire at age 60 debt free and live fairly comfortably? I'd like to have a net income of roughly $50,000 annually. I don't really want to work until age 65, but I will if I have to so my money doesn't run out in retirement. — *Robert V.*

FP Answers: Congratulations Robert for considering these questions well in advance of your planned retirement date. This allows you to put strategies in place now and adjust if needed as you get closer to your goal.

Right now, you have an after-tax income of about $91,000 annually. Of that, you spend $55,000 (including mortgage payments) and put $36,000 in savings. I am assuming the $125,000 of income is after business deductions and before taxes. If you can continue to save at the same rate for the next 15 years, and finish paying off your mortgage in that time frame, you could contribute another $540,000 to your total savings.

Let's start by making a few other assumptions. Let's assume you continue to invest in your TFSA at a rate of $6,000 annually and to your RRSP at $20,000 annually. Let's also assume an average annual moderate rate of return of 4.5 per cent on those funds, which is the typical return for a portfolio equally split between equities and fixed income.

Now, let's further assume you will contribute $10,000 annually to your non-registered investment account over the next 15 years and that money will be fully invested in equities, which will give you an annual average rate of return of six per cent.

As for your pension entitlements at age 65, let's say you take Old Age Security (OAS) and it totals $7,384 — the maximum — and Canada Pension Plan (CPP) will be the national average of $9,229 annually. Finally, your $1,500-a-month mortgage, with an assumed interest rate of 3.5 per cent, will be paid off by retirement.

Crunching the numbers shows you would have sustainable after-tax spending from age 60 to age 95 of $76,000, which is $16,000 more than your annual goal of $50,000.

If you die at age 95, your condo — assuming an annual increase in inflation of two per cent — will be worth almost $1.4 million. At that time, all your investments will have been completely drawn down.

There are some other points to consider. First, you could pay more down now on your mortgage principal to allow an earlier retirement. Check the pre-payment terms with your lender if you're interested in pursuing this option. Second, you could reduce the amount of your current savings to allow for increased spending on more discretionary items now such as travel, hobbies, renovations, etc.

You may also want to consider that your living arrangements could change due to your health situation at some point in retirement. If this happens, you could sell your condo or access the equity to cover those extra expenses through a line of credit or reverse mortgage if needed.

In making a choice between paying down a mortgage that has a lower rate of interest or investing the money at a higher rate of return, it may seem logical to go with the investment option, thinking your money is being put to better use with a higher return.

But some decisions are also about lifestyle and financial independence, meaning earlier retirement. For example, some people will consider semi-retirement, which includes a part-time job to earn enough money to pay off the remaining mortgage balance. These are lifestyle choices you need to make when deciding what to prioritize going forward.

As you can see, Robert, there's a fair amount of flexibility in this scenario to allow you to offset the natural fluctuation of self-employed earnings if you choose to work less and retire earlier. Knowing this, you may want to give more thought to whether retiring a bit before age 60 with some part-time work after that is an attractive option for you.

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