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Debt Reduction as a Retirement Savings Strategy

Statistics Canada recently reported the ratio of household credit market debt to disposable income reached the highest level since the agency began tracking this figure. In 1990 it was 50%, rose to 110% in 2000 and jumped to 171% by the fourth quarter of 2017. This can cause some angst for those with children reaching post-secondary school age.

Sam and Marsha* are in their mid-forties and have a 17-year old daughter, Alicia. They have lived a more frugal lifestyle than most in their age group. Until now, they haven't given too much thought to when and how they want to retire. Now with their daughter already looking at colleges, and with a sizable amount of debt weighing them down, they know that they will have to make some serious choices.

Their primary focus up to this point has been to ensure that Alicia has a quality education. They have steadily contributed funds to Alicia's RESP and have relatively little in investments or savings. Their two mortgages, one on their principal residence and one on a small rental home, loom large over their retirement horizon. They are now ready to take some steps to get themselves in a better retirement position. They have even considered selling their rental home as an option. This may not be a wise choice.

They both earn good incomes. Together, with Sam's income from his contracting business and Marsha's teacher's salary, they earn about $150,000 per year. Their only real assets are the two houses they own, which managed to hold their value pretty well in spite of the last economic downturn. They have about $11,000 in savings and Alicia's RESP has grown to $12,500. After accounting for their two mortgages of $564,000 and a small equity line of

$18,000, they are left with about a $105,000 net worth which they want to grow substantially between now and retirement.

Marsha will receive a nice pension which should give them an adequate base of retirement income. Their rental income can also add to that base of income with another $1,000 a month once they pay off its mortgage. The rest of their income will need to come from their retirement funds, which will not receive a lot of their savings dollars until after Alicia completes college.

A good course of action would be to concentrate on paying down their debt as much as possible between now and the time Alicia goes to college and avoiding any new consumer loans. Then, upon her graduation, apply the funds previously used for college expenses to a combination of retirement savings and further debt reduction.

They should consider accelerating both of their mortgages by making extra principal payments and making weekly instead of monthly payments. Paying down mortgages more quickly can, in effect, act as a forced savings plan that will free their equity to be used in retirement.

Sam and Marsha need a financial map to keep them on a focused path to financial independence. At their age, they just can't afford to wait any longer.

(Fictional characters for illustrative purposes only.)*

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