DEMOGRAPHICS

Hey millennials, it's never too early to jump into RRSPs

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When you're in your 20s, retirement planning is not usually top of mind.

More often, money worries related to rent, student debt and credit cards take precedence. If you're lucky enough to have a job that pays well, you might be thinking about saving for a big-ticket item such as a car or a house.

However, as the March 3 deadline for RRSP contributions approaches, some millennials might be wondering whether they should invest in an RRSP this year – especially because it could result in a sweet refund after they file their income taxes.

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Should you take the RRSP plunge?

Kurt Rosentreter, senior financial adviser at Manulife Securities Inc. and a certified financial planner and chartered accountant, says that in his experience, getting people in their 20s to focus on structured personal finance can be a bit of a challenge. At the same time, getting an early start on saving could be more important than ever.

"The word retirement is disappearing for fiftysomethings," Mr. Rosentreter says, "and the twentysomethings will be further behind the eight ball because none of them have pensions any more."

Annie Kvick, a certified financial planner and money coach in North Vancouver, acknowledges that it can be hard to think about your financial future when you get out of school and land your first paycheque. "But the sooner you do it, of course, the better it is," she says.

RRSPs are still the "cornerstone approach" to taking that first step toward retirement savings, Mr. Rosentreter says. When considering an RRSP contribution, though, it's important to look at your debt load first, he says. Rank your debt from the most expensive to the least expensive, and work to pay off any high-interest debt before taking on an RRSP.

"The most expensive, almost universally, is credit-card debt," he says. "Then, lines of credit. Then, it gets a little bit interesting, because it could be student debt."

If student debt is financed through a government, Mr. Rosentreter says, you can get interest breaks and deductibility, and it's not usually an expensive debt to carry. "But often, what I'm seeing is kids cannot qualify for student loans because their parents' income is too high, so what they are doing instead is financing it through a line of credit that is guaranteed by a parent in some cases," he says. "That's often a higher cost of financing without interest rate breaks."

Although "we want to be debt-free in the grand scheme of things," Mr. Rosentreter says, twentysomethings carrying some low-interest debt might still consider an RRSP, particularly if they work at a company that has a pension plan in which the employer matches the contributions made toward an RRSP.

"There is often some element of a matching program, and you are crazy not to take advantage of it, because it's basically free money when they are putting in 3 per cent to match your 3 per cent, or something like that," he says.

Fewer financial responsibilities

Millennials can also take advantage of having fewer financial responsibilities than they will when they get older, says Vickie Campbell, a certified financial planner at Ryan Lamontagne Inc. in Ottawa.

"If they have a little extra money because they don't have a lot of expenses at that age, they can have that money compounding as they go through those more expensive years when they may have house payments and children," Ms. Campbell says. "If they can put a little bit away, it sets up a fantastic foundation."

But what about the motivation of getting that RRSP because it will win you a tax refund? Ms. Kvick warns that going for the immediate windfall might actually hurt in the long run.

"Going for the quick tax break might feel like, 'Great, now I can go on a vacation,' but next year you might get a 30-per-cent tax break [if your income rises]," she says. "So it really comes down to taking a long look at what you should be doing, and not just going for the quick refund."

The other mistake people make, Mr. Rosentreter says, is getting that tax refund in their hot little hands and spending it frivolously.

"If you get the refund and use it to take a trip or blow it, you're really negating the powerful impact of

the tax sheltering that you get from the RRSP," he says. "It would be a lot better if you take the refund and accelerate debt repayment or put it back into next year's RRSP. The compounding impact of being responsible with the refund is a key part of this that can be overlooked, too."

RRSP vs. TFSA

What about the question of RRSP versus a tax-free savings account?

Mr. Rosentreter says it's important to look at priorities when considering an RRSP versus a TFSA. The latter can be a good way to create an emergency fund or save for a short-term goal such as a vacation, Mr. Rosentreter says, because there are no penalties for withdrawal (as there are with RRSPs).

But when it comes to saving for a house, a common goal for millennials, an RRSP is a great choice because of the Home Buyers' Plan, he says. Canada Revenue Agency allows people to withdraw up to $25,000 from an RRSP to put toward a home purchase, to be paid back over the following 15 years.

"If you start to look at how you can achieve multiple things with fewer steps, the Home Buyers' Plan lets you save up to $25,000 in your RRSP, get the benefits of the tax deductions of the RRSP initially, get the benefit of the deferred growth inside the RRSP until you take it out, then remove the money and use it as a home deposit – it's a double win," Mr. Rosentreter says.

Ms. Kvick suggests that potential home buyers can maximize the benefits of an RRSP by taking their tax refund and putting it in a TFSA.

"Then you can use your TFSA for other closing expenses you might have with buying a home, like land transfer taxes and legal fees," she says. "You can get your house that much quicker by using the RRSP and putting the refund to the TFSA."

When it comes to utilizing the Home Buyers' Plan though, it's important not to let the repayment drag out, Mr. Rosentreter says, because you're losing the compounding power of your RRSP.

"You want to pay it back in an accelerated way, so you can go back to focusing on RRSP maximization as well as now paying down your mortgage. You need to achieve both goals at once," he says.

If you can't quite make an RRSP contribution this year because you haven't saved up enough money, set up an automatic, monthly contribution with your bank so that the money comes directly out of your paycheque, Ms. Campbell says, in preparation for next year's contribution.

"A monthly contribution can be a bit easier to manage than coming up with the lump sum," she says. "If you start on a regular basis and make sure you make that contribution regularly, you'll be surprised by starting early how much it will help you."

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