Mortgage payments vs. refinancing vs. savings dilemma

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By Karin Price Mueller/The Star-Ledger

Q. We are both retired and we purchased a new home in an active adult community. A mortgage was necessary because the sale of our old home did not generate enough money to purchase the new one. The mortgage is $125,000 at 5.5 percent for 30 years. We have about $40,000 in a brokerage account which is not generating any significant income. Should we pay down the current mortgage, refinance at a lower rate, both, or use other retirement savings to clear the deck?
– DNB

A. The Brain’s advisors have done a bunch of math for you.

Your mortgage payment is now $709.74 a month. You are paying about $6,800 a year in interest for the first few years. That’s is deductible, but you are probably in a very low tax bracket, said Reed Fraasa, a certified financial planner with Highland Financial Advisors, so your after-tax cost is still high. The total interest cost over the life of the loan is $130,503.

Fraasa said you could probably get your payment and interest down by refinancing at between 4.5 and 4.75 percent interest in this current market.

"If you did as you suggest and use $40,000 to pay down the debt and refinance at 4.75 percent, your mortgage would be about $443 a month and your annual interest for the first few years would be about $4,000," he said. "The total interest cost over the life of the loan is $74,624. That is an interest savings over 30 years of over $55,000."

However, there would be a cost to refinance. Depending on whether your current mortgage holder would renegotiate the loan and not require a new title policy, it could cost you as much as $1,500 to refinance, with another $1,000 to $1,500 if you needed another title policy, Fraasa said. "In that case, the breakeven to do a refinance could be from 0 months to about 13 months. Not bad considering the lower payments and interest savings. You would be locking in the lowest rates we will see for a long time," he said.

To your question about liquidating other retirement savings accounts to further reduce the debt, Fraasa’s not so sure that’s a good idea.

"If you withdrew funds from a retirement account you would incur taxes prematurely. That would not be recommended. You should defer taxes as long as possible," he said. "The additional income from withdrawing the funds could also affect the taxation on your Social Security as well for that year."

Another option would be a refinance to a 15-year fixed rate mortgage at 3.5 percent, said Marnie Aznar, a certified financial planner with Aznar Financial Advisors in Morris Plains. She said although your payment would increase to $893.60 per month, the total payments over the life of the loan would be $160,848 versus a total of $255,505 on your existing loan.

"This would represent a total savings of almost $95,000 over the life of the loan with an incremental increase of only $184 per month from what you are paying now," she said.

If you were to refinance to a 3.5 percent rate, assuming you receive a tax benefit from itemizing your deductions, the after-tax cost of the mortgage would end up being less than 3 percent, she said.

—Karin Price Mueller

*E-mail your questions to **askbiz@starledger.com**.*

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