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Ann Perry

Mortgage Payoff Attracts Heated Debate

By Ann Perry
Senior Writer

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For most of us, our home is the biggest investment we'll ever make. Likewise, the accompanying mortgage is the largest debt we'll ever take on.

But how fast should we strive to pay it off? Is it good planning to be mortgage free upon retirement? With financial markets faring so poorly these days, why not pay down your loan for a surefire 5% or 6% return?

There's no consensus in this frequently and hotly debated question.

Financial author and guru Suze Orman says to make it your No. 1 priority to have your mortgage paid off by the time you retire.

Bert Whitehead, attorney, crusading fee-only financial planner and head of Cambridge Advisors network, however, advocates keeping the mortgage, taking the tax write-off and using any excess cash in more productive ways.

Eric Tyson, author of *Personal Finance for Dummies* sums it up this way: Paying down your mortgage is "investing your money in a sure thing with a modest return."

Here's what he means. If you have a 6% mortgage and you're in the 35% combined federal and state tax bracket, paying off your mortgage early gives you a return on your money of 3.9 %. However, if you invest that cash in the stock market for the long term, more than 10 years, you should earn 10% pretax and 6.5% after taxes -- a difference of 2.6 percentage points.

The difference is even greater if you plough your excess cash into a tax-advantaged account, such as a 401(k), individual retirement or college savings account.

"If we just look at the simple math," says Sheryl Rowling, CPA and certified finance specialist with Rowling, Dold & Associates LLP in San Diego, "you're better off with a 30-year mortgage and investing the money." And it doesn't matter what the markets are doing now, she says, it's how investments will perform over the long run.

But applying simple math doesn't begin to explain how many homeowners approach this topic.

"They don't want to hear it," says Marnie Aznar, CFP, Aznar Financial Advisors in Morris Plains, N.J., who works with young professionals. "They don't care. They just want that mortgage gone.

"For some people, it's a very easy form of saving compared to mutual funds. They can feel it. It's real. So much depends on their risk tolerance."

Some homeowners who see mortgage prepayment as a safety net could in fact be taking a risk by limiting their financial flexibility, Aznar points out.

"When you're paying down your mortgage, you're investing in your home," she says, and not diversifying into other alternatives. "The neighborhood could change." If the neighborhood begins to decline, property values could dip or fail to keep up with other neighborhoods.

Also, if you need the money, you might have to resort to taking out a home equity line of credit at higher interest rates at a later point in time to tap what you've put in. (Note that financial advisers recommend such a line of credit as a standard component of your porfolio because it is often impossible to get one following an emergency, such as a job loss or medical crisis.)

Leonard. L. Goldberg, CFP, of Goldberg Capital Management in Avon, Conn., believes that prepaying mortgages or employing 15-year loans over 30-year loans can be a good strategy, but he encourages clients to move with caution.

"People feel they have to rush into this decision, that they have to take this off the table," he says. In pre-retirement planning, he will recommend that "they wear it for a while because it doesn't have to be done all at once."

In managing his clients' money, Goldberg believes he can get a better return for them from the equity market than they can get by paying off their mortgages. So he usually recommends that they tap no more than 10% of their investment assets to chip away at the mortgage.

But as clients near retirement and want to pay off their mortgage, he suggests taking a big bite at a time if they are able -- say $50,000 out of a $150,000 mortgage.

Some members of the baby boom generation are expected to enter retirement with lots of debt, such as credit card balances and mortgages, due in part to the extremely low interest rates of recent years. Many have refinanced in 30-year loans adding cash-out and have also taken on extra debt through home equity loans.

While this could be a real problem, some financial advisers say there's nothing wrong with having a manageable-sized mortgage in retirement, that the boomer generation will behave differently in retirement than previous generations. Having a mortgage, these advisers say, will allow retirees to continue to itemize their tax deductions, serving as a "gateway" to bigger tax breaks.

Goldberg, however, is not enamored of this approach: "I don't think you should ever go out of your way to find a tax write off, especially with an older person who's in a lower tax bracket."

As mortgage holders near the end of a mortgage term, they are not paying much interest anyway, notes Aznar, and should check to determine if they would be better off relying on the standard deduction rather than itemizing when filing a tax return.

Payments on a 30-year, fixed-rate mortgage go mostly toward principal during the final 10 years. Of course, a homeowner who takes out a 30-year, $250,000 loan at today's rate of 5.42% would pay almost $140,000 more in interest payments over the life of the loan than one who gets a 15-year loan at 4.84%. For a dynamic mortgage calculator that makes figuring out this kind of thing fun, visit www.jeacle.ie/mortgage/.

A 15-year mortgage is ideal for someone with a very secure job and good cash flow. The 30-year loan is a better choice for someone with an uncertain job field but a desire to prepay. Most lenders allow borrowers to prepay at will with no extra charge.

Goldberg, who likes 15-year mortgages for those who can afford it, loves that he was recently able to refinance his mortgage with a 10-year note that will pay off as his children start college.

Before joining TheStreet.com, Ann Perry was the personal finance columnist for The San Diego Union-Tribune. She is the author of "The Wise Inheritor: A Guide to Managing, Investing and Enjoying Your Inheritance" (Broadway Books, 2003). She has a B.A. in English and Communications from Stanford University and a master's degree from the Columbia University School of Journalism. She can be reached at Ann.Perry@thestreet.com.
