The Signalert Scoop

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Should You Tap Your Investment Accounts to Pay Off Your Mortgage?

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Clients sometimes come to me wondering how quickly to pay off their mortgages. Each person's situation is different, so I make a recommendation on a case by case basis. This article discusses some of the issues that can help guide you to make the best decision.

Favors Pre-Paying Mortgage	Favors Stretching Out Mortgage Payments
High mortgage interest rate	Need for liquidity
Investments mostly in taxable accounts	Investments in retirement accounts
Low expected investment return	High expected investment return
Desire to minimize fixed monthly expenses	

Table: Summary of selected issues that argue for and against pre-paying your mortgage

Expected investment return compared to the mortgage rate of interest

In general you can usually expect your long term average investment return to exceed current mortgage rates. (Of course, future investment returns are not guaranteed.) That means, all else being equal, you will potentially end up with more money if you pay off your mortgage as slowly as possible and leave as much as possible in your investments. This is especially true if your investments are in tax-deferred retirement accounts.

However, there is more to the story. Mortgage prepayments are essentially a risk-free investment, while even a conservative investment program has some risk. So, for example, if your mortgage carries a 4% rate, that exceeds the risk-free (or nearly risk-

free) returns now available. From this perspective, I would view a mortgage pre-payment as a low-risk bond offering an above-market return. This goes double for any other type of debt for which the interest is not tax deductible. When I advise clients I analyze their other investments in conjunction with the virtual bond that is a mortgage pre-payment in an effort to guide them to make the best decisions for them.

On the other hand, if you happened to have locked into a lower mortgage rate, particularly if you paid points, then it is probably worth the risk of investing rather than pre-paying.

Your need for liquidity

We invest clients' assets in a manner that makes them available on short notice when needed. On the other hand, once you make additional payments on a mortgage, that money is no longer available to you in case of emergency. Therefore, before you consider pre-paying your mortgage you should make sure that you have reserve of cash or investments that you can access in case unexpected expenses arise.

If you have significant equity in your home after years of paying down a mortgage you might be able to reduce your monthly payment by refinancing the remaining balance on the mortgage to stretch out the payments much further. Although this could mean that your mortgage will outlive you, it can also meaningfully reduce your monthly expenses. If you have trouble meeting the burden of a large monthly payment from an old mortgage, this course of action could relieve some of the pressure from your budget.

Tax situation

If your investments are in tax-deferred retirement accounts and you have significant tax-deductible mortgage interest to pay, your tax situation is potentially very favorable because investment earnings are tax-deferred while the interest is tax-deductible. In this case, you might be able to find an optimal amount to distribute from your retirement account without bumping you up into a higher tax bracket. Of course, if you are over age 70 ½ or if you inherited your IRA, you have to meet minimum distribution requirements regardless of the tax consequences.

Peace of Mind

Some people prefer to have as low a fixed monthly living expense as possible while others prefer to have a larger nest egg even if that means bearing the added expense of a monthly mortgage payment. Whichever of these scenarios will allow you to sleep best at night depends on your personality and on the particulars of your financial situation.

Bottom line: There is no one answer that is right for everyone, but with some thought and care we can come up with a good solution for you. Clients are welcome to call me anytime to discuss your individual situation with this or any other financial planning question.

Disclaimer: Signalert does not offer tax advice. We recommend that you consult with your investments, tax and/or legal advisors before acting on any recommendations in our Scoops.

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