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6 Considerations For Retirees To Pay Off Your Mortgage Early

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Paying off your mortgage before retirement used to be one of the life's primary goals. Now, many retirees not only have mortgages, they are sometimes very large ones. What is the right approach? If you listen to the financial gurus on TV or the radio, you get varying opinions, depending on which "expert" you ask. The answer is never a simple one and always depends on each person's individual situation, not on the blanket opinion of so-called experts.

On the surface, paying off your mortgage early could save you thousands of dollars on interest payments while lowering your monthly expenses. After all, paying off that loan is, in a sense, a guaranteed rate of return. You are guaranteed to not pay that interest any longer. Sounds like a no-brainer, but there are several factors to consider first.

1. Your risk tolerance. These days, the cost of keeping a mortgage is very low due to the historically low interest rate environment we are in. You often hear the argument that you should never pay off your mortgage since you can earn more in a diversified stock and bond portfolio in the long term. If you can earn, for example, 8% in a diversified portfolio and your mortgage is 4%, then you make an extra 4% by keeping your assets invested. However, investing your equity rather than paying off your mortgage does not come without risk. This strategy only makes sense if you have a high risk tolerance, greater than ten-year time horizon, and understand the risks. On the other hand, if you are unwilling to take on additional risk, and only comfortable investing in conservative investments such as Treasuries or CD's, you will probably not earn enough growth on your investment to outpace your mortgage rate.

2. Your liquidity level. Paying off your mortgage by draining all your liquid savings may actually make you less financially secure. When you deplete your savings, you give up a financial safety net. If a financial disaster happens, you may be forced to make financial decisions that are much costlier than keeping your mortgage. Never dip into your emergency funds to pay off long term debt.

3. Other Debt. There is a cadence to paying off debt. First, you will want to pay off other debt that has higher interest rates than your mortgage, saving you expensive interest payments. Second, consider paying off debt that has a short term teaser rate before paying off the mortgage. Keeping a debt with, for example, six months zero interest only to watch it balloon to 16% afterward will not save you money in the long term.

4. Other pay off sources. If you plan to pay off your loan by taking a withdrawal from a 401(k) or IRA, you may want to reconsider for tax purposes. For example, if your current income puts you in the 12% tax bracket and taking a large distribution puts you in the next tax bracket (22%), that withdrawal is potentially costing you an extra 10% in taxes. A better strategy may be taking a smaller distribution to the top of the 12% bracket and paying off just part of your mortgage. Next year, evaluate your tax situation and continue to pay off your mortgage using the same strategy of topping off your tax bracket.

5. Refinance to a lower rate. If you are paying a high interest rate and you have good credit, then refinancing to a lower interest rate can cut costs. Refinancing to a lower rate and a shorter term can help pay off your home sooner without depleting your savings. Shop interest rates and closing costs as there can be a substantial cost difference between mortgage companies.

6. Downsize your home and housing expenses. If the monthly cost of your home is unmanageable and you own a larger home, then selling your home and downsizing may make sense. Often empty nesters do not need as much space. Downsizing to a smaller home or even to a less expensive area can cut costs substantially. But be aware, buying a new home will generate other costs. Your current home may need updating or maintenance. There are commissions when using a realtor. Your new home may need work. All these costs can be substantial.

The decision on whether to pay off your mortgage is very important and complicated. It is always a good idea to consult with a financial advisor when making these major financial choices.