Dollars & Sense

I Paid Off My Mortgage — Should You?

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I cut a check and paid off my mortgage in February, making me debt-free. It cut my living expenses by about a third and ensured that in four years, at the age of 45, I'll be financially independent and eligible for military retirement. What a glorious feeling! Should you pay off your mortgage as soon as you can?

Benefits of Paying Off Your Mortgage

You have one less thing to worry about! You've got food. You've got water. Now you've locked in your shelter and may be debt-free on top of that. You can move from "safety" to "love and belonging" on Maslow's hierarchy of needs.

It reduces your fixed monthly expenses, which goes a long way toward setting you up for retirement, fewer shifts, or even an alternative career path. Housing is usually a large percentage of your monthly expenses, and everyone who decides to purchase their primary domicile should make being mortgage-free a primary goal by the time of retirement.

It saves you money, since you'll likely save tens of thousands of dollars in interest you otherwise would have paid. In addition, if you no longer have a mortgage you should be able to reduce the amount of life and disability insurance you are paying for each month.

Without a mortgage, you can save and invest more money every month. Before I paid off my mortgage, I saved 30% of my gross income. I'm not sure how much I'll save now, but it'll be more than 30%.

When you pay off your mortgage, you are getting a guaranteed rate of return on the investment. In my case, the rate on my mortgage was 3%. I'm usually in the 33% tax bracket, which means that every dollar I put toward paying off my mortgage earned me a guaranteed return of 2%. This is a remarkably similar return when compared to most low-risk bond yields in recent years. In fact, this is exactly why I paid off my mortgage. I wanted to have a small portion of my retirement savings in bonds, but it made no sense to own bonds that would pay me 3-4% while paying 3% on my mortgage. Paying down your mortgage is a reasonable substitute for buying bonds.

There can be asset protection benefits to paying off your home loan. Some states provide unlimited asset protection for home equity, which makes it nearly impossible to lose your home if a lawsuit doesn't go your way. Other states, however, protect very little of your home equity. If you want to see what your state protects, go to this link and look for each state's "homestead exemption": www.assetprotectionbook.com/forum/viewtopic.php?f=142&t=1566.

If you are paying a financial advisor who charges you a fee based on a percentage of your assets under management, by taking some of those assets and using them to pay off your house, you reduce your investment expenses.

Benefits to Keeping Your Mortgage

When you make your mortgage payment, some of it goes toward principle and increases the equity in your home. For me this was about $2,000/month of forced savings. If you are not financially disciplined, making a mortgage payment will ensure that every month you are squirreling away at least a little bit of money.

Mortgage rates are still near their all-time lows. If you can borrow money at 3-4% and invest it in something that will give you a higher net return, it makes sense to invest the money instead of paying off the mortgage. That said, you have to make sure that you actually invest the money. In addition, there are very few investments that guarantee a return greater than your mortgage. Actually, there probably aren't any, because of the word "guarantee." Yes — stocks, high-yield or corporate bonds, real estate, etc., will probably make more than 3-4%, and you can protect yourself by diversifying — but that is certainly not guaranteed.

The after-tax mortgage rate you are paying may be below inflation. For example, my after-tax mortgage rate was 2%. If inflation had been above 2%, I would have been getting paid (in real terms) to borrow money! The value of real estate tends to rise with inflation but your mortgage payment is fixed, so when inflation increases the value of your house but your mortgage payment remains the same, you are paying the loan back with dollars that are worth less and less as time goes on. When your mortgage is paid off, you give up this benefit.

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What Should You Do?

Like most financial decisions, situations vary and this decision can be complicated. The best online article I could find that goes through all the complexities of the issue, which my brief article does not, can be found here: https://financialmentor.com/financial-advice/pay-off-mortgage-early-or-invest/7478.

You should always maximize contributions to your retirement accounts, pay off all non-mortgage debt that has a higher interest rate, and save for your children's education before you consider paying your mortgage off early. But if you find yourself having taken care of all of this, and weighing investing in bonds versus paying off your mortgage, you can't beat the peace of mind that comes with being mortgage-free!

If you have ideas for future columns or have other resources you'd like to share, email me at jschofer@gmail.com.

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