Carrying mortgage into retirement can pay off

Many people dream of a mortgage-free retirement. The goal of having a mortgage paid off in time for retirement is one of the most common specific goals I hear in my practice. However, there may be times when it's in your financial interest to continue, and even maximize, your home mortgage during retirement.

In most of the cases I've analyzed, the potential advantage of continuing the mortgage is not important enough to demand it. But, in other cases, continuing to carry a mortgage in retirement can be critical to giving yourself the chance to achieve other important goals. Putting money into paying down your mortgage is choosing to invest in a piece of real estate, instead of investing it elsewhere - stocks, bonds and cash, for example.

Federal annuitants are often in a better position than most to continue carrying a mortgage into retirement. If most or all of your essential retirement spending needs will be funded by guaranteed income from a Civil Service Retirement System annuity or Federal Employees Retirement System annuity and Social Security, you can more easily accept the risks associated with investing for greater potential returns.

Here are a few of the arguments in favor of continuing a mortgage:

Real estate is illiquid. Financially speaking, retirement is all about cash flow - having the money you need to spend, when you need it. One problem with diverting money from your savings into your home is that if you later need that money to support your retirement spending, you may not be able to get to it - at least, not on reasonable terms.

A mortgage is relatively cheap money. Low interest rates and tax breaks make mortgage money just about the cheapest money you can borrow. If you're going to borrow money to invest for retirement, this is often the best way to do it.

A mortgage provides financial flexibility. The right to prepay a mortgage, at your discretion, means that you have the option to act in ways that further your interests. Suppose that you have a 30-year fixed mortgage with a 5 percent or 6 percent interest rate. Ten years from now, if market interest rates have risen to 10 percent for a similar mortgage and bank certificates of deposit are paying as much as 10 percent per year, the money that you don't have tied up in the house is available to invest at higher rates and you'll be bragging about your low-interest mortgage at cocktail parties. On the other hand, if rates go lower in the future, you have the option of either paying off the loan or refinancing to better terms, if they are available.

The cost of mortgage money today can be as low as about 3 percent per year, after the tax benefits are considered. It is reasonable to expect that even a conservative investment strategy based on an allocation of 45 percent stocks and 55 percent bonds and cash, if competently managed, will produce an after-tax return of at least twice that. This advantage can mean that you'll be able to spend more, after adjusting for the costs of the mortgage payment, by investing the money outside of your home.

I don't sell investments or have a financial interest in where my clients choose to invest their money. For some retirees, living mortgage-free will be the right choice. But for many, it won't.

How your money is invested and managed is a critical ingredient in any financial plan. If you don't have competent, trustworthy and reliable investment management, then you might be better off with your money in your home - or maybe the mattress.

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Byline: Mike Miles