SHOULD YOU PAY OFF YOUR MORTGAGE EARLY

Which is better: To retire without a mortgage or keep the mortgage and retire with a bigger nest egg?
More Americans approaching retiring face what some describe as worrisome levels of debt, especially mortgage and credit card debt. Consider: More than half (55%) of the American population age 55 to 64 carry a home mortgage, and about the same fraction (50%) have credit card debt, according to a paper presented at the 15th Annual Joint Meeting of the Retirement Research Consortium held earlier this month in Washington, D.C. What's more, that debt isn't going away after retirement. Among people age 65 to 74, almost half had mortgages or other loans on their primary residences, and more than a third held credit card debt according to the paper, Debt and Debt Management among Older Adults .

Crash-proof blue-chip stocks
If you've seen big gains in 2013, it may be prudent to trim back your winners, but where do you put that cash if you do? And that debt can be a problem, especially for those who are less financially literate, according to the authors of the paper, Annamaria Lusardi, a professor at The George Washington School of Business, and Olivia Mitchell, a professor at The Wharton School, University of Pennsylvania. Such debt can be hard to pay off during retirement, especially in the absence of earned income. Plus, in the worst of cases, such debt can lead to bankruptcy according to Lusardi, who, along with Mitchell, is the co-author of "Financial Literacy: Implications for Retirement Security and the Financial Marketplace." Given the problems that debt can cause in retirement, we thought it worth asking the following questions: What's the better tactic? To aggressively pay down one's mortgage down before retirement and stop or perhaps reduce one's savings for retirement? To keep saving for retirement and retire with mortgage debt? Or should you split the difference—save a bit less for retirement and pay down one's mortgage a bit more aggressively?
It depends
Well, as with most things having to do with money, the answer depends on your personal situation. "My answer would be that it depends on the facts and circumstances," said Mitchell. Not surprisingly, many agree with Mitchell that it's impossible to decide without crunching the numbers whether it's wise to pay down your mortgage before retiring at the expense of saving less retirement. "I do not think there is a general advice to give without knowing more about personal circumstances," said Lusardi. And Kathleen Mealey, a financial counselor with Cabot Money Management, is in the same camp. To begin to answer the question, she said you need to assess how ready you are for retirement today given your current savings and your goals and plans for the future.
Others share that point of view. "The question is not a simple one to answer as there are a number of variables that would come into play," said Mike Kenney, a consultant with Nationwide Financial. Those variables include current income, current savings, current tax rates, your Schedule A itemization before and during retirement, whether you have access to a Health Savings Account, your retirement income needs with and without a mortgage, your mortgage balance, the number of years remaining on your mortgage, and interest rates and opportunities to refinance—among many other factors. Earlier this year, a survey showed that most people think paying off their mortgage was among the smartest financial decisions they ever made—along with starting to save when they were young.
Tax consequences must be weighed
The tax consequences of pursuing one tactic or the other must also be considered. "They are tax advantages to pension contributions and interest payments on mortgages are tax deductible so one has to compare these

advantages," Lusardi said. Mealey agreed, saying that contributing to a 401(k) and deducting interest payments from a mortgage could be beneficial, especially if it puts you in a lower tax bracket. "If the answer will be a combination of both 401(k) contributions and paying off mortgage, work at keeping tax brackets low," Mealey said. A word of warning: You are likely to lose much of the benefits of deducting mortgage interest payments the closer you are to paying it off in full. Also, consider this fact: You do get a tax deduction with your 401(k) contribution. But the deduction only defers your taxes, noted Michael Kitces, publisher of Nerd's Eye View, partner and director of research for Pinnacle Advisory Group, and a RetireMentor at MarketWatch.

What's the higher return on investment?

Mealey and others also suggested that you pursue the tactic that offers the highest return on your investment. "What is the mortgage interest rate and length of time remaining?" she asked. "Compare this with the 401(k) investment options. If the long-term rate of return on the 401(k) plan will be higher than the mortgage and there is a comfort level with the risk involved, it may not be advantageous to pay off the mortgage." For some, this is a no-brainer. "With current low interest rates that are fixed for a number of years, a retiree can possibly have a better return on the money in a long-term objective portfolio than the 3 or 4% interest payment," said Michael Callahan, president of Edu4Retirement On the other hand, if you aren't earning much on your retirement investments, if you have low or negative returns, it might make sense to pay down your mortgage, Mitchell said.

"If one is holding assets in a money market mutual fund earning 0.5% while paying 5% on his or her mortgage, paying down that mortgage may be a clever strategy," said Lusardi. Kitces notes the following in an upcoming issue of MarketWatch's Retirement Weekly subscription newsletter: "At the margin, choosing to not pay down your mortgage and invest in your 401(k) instead is the equivalent of choosing to invest with leverage since you're keeping a loan and buying stocks."

Reasons to not pay down mortgage

That said, there are some general rules to follow. For instance, Kenney suggests that you not pay down your mortgage unless you already have has ample assets to cover all retirement income needs and/or are making the full allowable contribution to your 401(k). "The likely outcome of paying off a mortgage early is increased taxation on earned income now, though this would not apply with a Roth 401(k), and increased taxation due to the loss of a potential deduction later," Kenney said. Mitchell suggested that one's house is a nondiversified, and potentially quite risky, asset. "In this light, hastening to pay off the mortgage may be the wrong thing to do," she said.

Reasons to pay down mortgage

In some cases, however, it might make sense to pay down your mortgage. For instance, if your mortgage rate is variable and you think interest rates are rising, that makes paying the mortgage off more appealing, Mitchell said. And some people, including Mitchell's husband, believe that the "right thing to do" is to pay off the mortgage since it helps them sleep better at night, she said. Others share that opinion. "The answer to the question will change with each person based on their current status, time frame, and risk tolerance," said Mealey. "No matter what the numbers may show, a critical piece to is to understand (your) view on debt. Sometimes no matter how strong the math, the true answer is what allows (you) to sleep well at night." Besides being able to sleep better at night, having your mortgage paid off pays off in other ways. You'll be able to qualify for a reverse mortgage, said Callahan.

Reasons to keep saving for retirement

There's one big reason to keep saving for retirement, advisers said. If your employer matches your contribution to your 401(k) in some form or fashion, that's "automatic return right away," Mitchell said. What's more, since many employers take the contribution out of your paycheck, "if you don't see it, you won't spend it, making that relatively easy," said Mitchell. Another expert, meanwhile, is fond of having cash in the bank or money in the market rather than a paid-off mortgage. "To me, cash is king," said Callahan. "If you can amortize the payment of the mortgage you have options by having the retirement savings on hand. You can always pay off the mortgage if the cash is available." Plus, he said, it forces a better financial plan while working since past decisions need to be completed while future decisions need planning and commitments. And, Callahan said, having a mortgage "may keep people working longer so that they won't overestimate the value of their retirement savings." Paying down your mortgage before retirement will also help you lower your expenses in retirement. And that's especially important since housing represents more than 30% of the expenses for average American 65 and older. Lowering expenses is a really critical issue in retirement. "With finite resources, keeping expenses low is essential," said Callahan. "Owning a home is very expensive. Upkeep…is not cheap.

Are you financially literate enough to retire with debt?

According to Lusardi and Mitchell's research, early boomers, as compared with previous generations at the same age, bought more expensive homes and got close to retirement with higher mortgage debt than other generations. Plus, they also have higher credit card debt. "This means that, in addition to deciding how to decumulate their wealth, this generation will also have to manage their debt well into retirement and these decisions are not that easy and do require some basic financial literacy," Lusardi said.

What's the answer for you?

The bottom line, at least for Mitchell however, is this: "I'd say do both—and keep working longer."

Robert Powell is editor of Retirement Weekly, published by MarketWatch.