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# CONDI

How She  
Learned to Be  
Fearless



## Paying House

They're planning to retire soon. Should they pay off the mortgage early or borrow more?

DENNIS AND KATHERINE HOYT, both 60, of Portland, Maine, are planning to retire in three years, but they still have \$50,000 left on their mortgage, which works out to about \$550 a month for the next 10 years. Sure, they have a good interest rate of 6 percent. But, they wonder, why pay any interest at all? Dennis, a landscaper, and Katherine, a photographer, who earn a combined \$60,000 a year, could use a chunk of their \$200,000 nest egg to pay down the mortgage and enjoy a debt-free retirement. Should they do it?

► **The Problem** The Hoyts' question is not as straightforward as it may seem. On the one hand, paying off your home and being able to live free and clear can be satisfying. On the other, for most homeowners it almost always makes sense to keep a mortgage, since the interest is tax-deductible.

The Hoyts, however, are nearing the end of their loan—which means they're

paying increasingly more principal than interest. In fact, they're paying less than \$3,000 each year in interest, which isn't enough to push their deductible expenses above the standard deduction for couples (\$9,700 in 2004). That means their loan is actually costing them a lot.

► **The Plan** From a purely financial perspective, the Hoyts would benefit

from a strategy that is growing in popularity as more folks retire with concerns about cash flow: borrow more. That's right. Some financial advisers are suggesting people bump up their mortgage and then invest the extra borrowed funds. The investment returns should more than offset the after-tax cost of the mortgage, so you profit from the loan, says Gibran Nicholas, president of Nicholas & Co. Mortgage Planning Solutions in Ann Arbor, Michigan, a mortgage-planning firm specializing in real estate issues.

Say the Hoyts took out a 10-year, interest-only mortgage for \$125,000, paid off the \$50,000, and invested the remaining \$75,000 in tax-free municipal bonds. While their monthly mortgage payments would go up from \$550 to \$625, their taxes would decrease, since they could deduct \$7,500 in interest payments, \$3,000 in property taxes, plus more for charitable contributions.

The \$75,000 investment also should provide a tidy sum each year in income. If they earn 4.5 percent on a municipal bond portfolio, which is a typical yield, they'll earn an annual \$3,375, or about \$281 a month. They could earn even more if they took out a bigger mortgage or invested in slightly riskier index or mutual funds.

Of course, going into more debt makes many people uneasy, says Harold Evensky, a certified financial planner at Evensky & Katz in Coral Gables, Florida. If you're one of them, you need to make the calculation in a different way. As a rule of thumb, if your mortgage interest is so low that it doesn't allow you to itemize your deductions, and your investments are earning less than the cost of the loan, then you should pay off the mortgage, Evensky says. "Ultimately" he adds, "you have to do what helps you sleep at night." ■

*Karen Hube is a financial reporter in Westport, Connecticut. Send in your finance-related questions and read past columns at [www.aarpmagazine.org](http://www.aarpmagazine.org).*