Pay Down My Mortgage or Save for Retirement?

As with any financial decision, there are pros and cons to paying off debt, such as a mortgage, or saving for retirement. The good news is that if you are facing this question, you're in a win-win situation: paying off debt and/or saving for retirement are both good options. And remember, it doesn't have to be either or; you can always do both at the same time!

Considerations for Paying Down a Mortgage

» Mortgages typically have low interest rates compared to credit cards and other loans, so sometimes paying off those other debts first makes more financial sense, because it saves higher interest costs.

» Paying off a mortgage early saves interest costs and helps to build equity in a home faster.

» If you do want to pay off a mortgage, it is usually best to make extra payments in the early years of the loan. Doing so reduces the principal balance, which ultimately saves interest in the long run.

» If you have a variable rate mortgage, paying the loan off early can save interest expense if interest rates rise during the term of the mortgage.

» If real estate values are falling, paying off a mortgage is like putting more money into a depreciating asset (at least temporarily, until real estate prices recover).

» Mortgage interest is only tax deductible if your itemized deductions exceed the new standard deductions (in years 2020 and later; visit www.irs.gov for the current amounts). If you do not itemize deductions, then paying down your mortgage can make sense from an income-tax perspective, because you're not going to lose the potential tax benefit of deductible mortgage interest.

» You simply like the idea of being debt-free, because you have the peace of mind knowing you will always have a roof over your head.

Considerations for Saving for Retirement

» You should nearly always pick up any employer matching contributions to a retirement account, if any are available. Matching contributions are essentially free money and increase your retirement account savings immediately.

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» If you are in a high income-tax bracket today, saving money in a pre-tax account (such as a 401k or 457 plan) will lower your taxable salary now, thus lowering the amount of income tax you pay currently. You pay less in taxes and your retirement account receives bigger contributions.

» If you are younger, saving for retirement now means more time for compounding, resulting in larger retirement account values in the future. But if you are older and your mortgage has only a few years left, paying off the mortgage can then free up more money to put into your retirement accounts after the mortgage has been paid off.

» If you think retirement investment returns in the long run will be higher than your mortgage rate, you could have an overall higher net worth (positive earnings on your retirement account less the cost of the interest you pay on your mortgage). For example, you expect to earn 5% on your retirement investments and have a mortgage with a 3% interest rate. In essence, you are 2% "ahead" overall.

Considerations for Both

» Remember that you can adjust your strategy over time as needed: if retirement investments are dropping due to bad financial markets, you can put more money into your retirement accounts (and thus "buy low"). But if investment markets are rising, you can switch and put more money toward paying off your mortgage and getting out of debt sooner.