

Debt: The good, the bad, the beneficial



Q: Is there any debt that is okay? I carry a balance on my credit card and I have a loan on my personal auto. My student loan will be paid off in four years and I have a 30 year mortgage. I just received a windfall and I'm not sure what to pay off first. I don't have enough to pay off everything.

A: Start by reviewing the interest rates of your loans. Check the credit card rate and the car loan and pay off the highest interest rate loan first. These loans are not tax deductible.

Is your mortgage interest rate competitive? Fixed 30 year rates are about 4% to borrowers with good credit. That's still a good deal.

Mortgage debt is considered to be "good debt" because it's invested in an asset that will usually grow in value over time. Homes are illiquid and should be long term investments.

Mortgage interest can be deductible on the Schedule A of your tax return. Review your real estate taxes and charitable contributions to find out if your itemized deductions will exceed your standard deduction.

Assuming your mortgage interest rate is in the 4% range; check your

investment returns for the past ten years. Are you averaging a higher annual return on your investments than the interest rate that you are paying? If you're an ultra-conservative investor and buy CDs that produce a taxable 1% return, then consider chipping away at your mortgage. If you're a moderate investor and your returns average 6% over the long term, then your tax-efficient investment return likely exceeds your mortgage interest rate.

Student loan interest may be tax deductible if it's paid to a qualified source. It also has to fall within modified adjusted gross income limits.

We don't know what we don't know. Plan for the unexpected. Instead of committing all of your cash windfall, build up an emergency fund. Stuff happens.

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