If I retire, should I be keeping a mortgage?

Q: I'm 58 years old and had planned to retire at age 65, but I'm considering retiring sooner. My job is not fun anymore because I'm required to work from home. I have a large retirement account and moderately sized investment account. Should I keep my fixed 3% interest rate mortgage, or should I be debt free?

A: Having a large tax deferred retirement account and a moderately sized after-tax investment account with an emergency fund provides more freedom and flexibility than a house without a mortgage.

After retiring, it's expensive and challenging to get cash out of real estate. Reverse mortgage fees tend to be high because of appraisal fees, closing costs, mortgage insurance premiums and loan origination fees. Since you have already paid for this 3% mortgage, ask yourself why it makes sense to pay it off.

Having a reasonable investment account that also holds emergency funds is a basic financial planning principle. It also provides freedom and flexibility. Surprise expenses happen and the emergency fund will prevent having to sell investments during market slumps.

Are you earning more than the 3% mortgage rate on your investments? NerdWallet reports that during the last century, 10% was the average annual stock market return. Individual investors rarely earn that, but we'll save that topic for another day.

It is not easy to mentally shift from the accumulation phase of life to the withdrawal phase. Emotionally, it's a huge adjustment. Expect that expenses will exceed income and that's okay. Save pretax earnings in retirement accounts when wages and tax rates are high. Withdraw from these accounts when taxes can be managed and are almost always lower.

Estimate retirement income from all sources. Next, calculate your retirement living expenses. Include replacing vehicles, celebrations and vacations, medical surprises and pricey home repairs. Guesstimate the total amount of the withdrawals needed and then determine the amounts to be withdrawn from each of the different (tax) types of accounts.

This exercise is all about saving tax dollars. Calculate the amounts to be withdrawn from each account (taxable, tax deferred, and tax free) because today's marginal tax rates jump from 12% to 22% to 24%. The goal is to take withdrawals from tax deferred accounts up to, but not into, the marginal 22% rate, thus saving 10% tax. Without significant after-tax savings, this tax strategy can't be applied.

Long term capital gains on investments have preferred tax rates that may be as little as zero when you're in the 12% marginal rate.

Mortgage debt is still considered "good debt" (credit cards are *usually* not) even if your 3% interest may not be tax deductible because of our high standard deductions.

Fiduciaries put clients' interests first and focus on their healthy, happy life. If having a low interest rate mortgage is causing anxiety, consider bucketing the funds needed for the payoff in a separate balanced fund. This action provides liquidity and earnings, as well as the comfort of knowing that the mortgage payoff is readily available.

A mortgage free retirement is a gratifying plan and provides significant emotional upside. It may also be a detriment to tax planning when there isn't extra cash and investment funds. Consider all aspects carefully before deciding.

Watch for IRS early withdrawal penalties and fees and consult your advisors.

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