Mortgage debt can be 'good debt' sometimes

Q: I am planning to retire in two years when I'm 62. I have a small mortgage at 5% interest and plan to keep my house at least another ten years. Should I sell investments to pay off the mortgage now? This would use most of my non-retirement account.

A: I assume you have long term capital gains on those investments; if you wait until retirement to realize those gains you may pay less tax.

Retiring debt-free is an admirable goal, however, mortgage debt is still considered "good debt" (credit cards are not). Your mortgage interest rate is 5%; are you earning that on your investments? Are you able to deduct the mortgage interest on your tax return? Under certain circumstances, it makes sense to keep a mortgage.

Accounting for the unaccountable is a great way to stay out of trouble and having an emergency fund is a basic financial planning principle. Without it, you may be forced to sell when the market is down.

Switching from the accumulation phase to the withdrawal phase is a huge mind-set change.

Expect your expenses to exceed your income. Retirement is why you've been saving.

Estimate your retirement income from all sources. Next, estimate your retirement living expenses. Determine withdrawals needed and then decide the amount to withdraw from the various accounts. Consider the effect of income taxes as you decide the amounts to take from each account (taxable, tax deferred, and tax free). Try not to go up to the next tax bracket.

Let's assume that you pay off the mortgage by selling your investments after you retire. It's typically not an irrevocable move. If you have an emergency and don't want to take additional distributions out of your IRA, consider a Home Equity Line of Credit (HELOC) as a short term solution.

A mortgage free retirement is a gratifying plan and has significant emotional upside, but it's also smart to have an emergency fund. If you can have both, that's the best answer. Your individual situation should determine if you pay off your mortgage at retirement. Watch for penalties and fees and consult your advisor.

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