Should you pay off your mortgage early?

The home mortgage as we know it today is relatively new from a historical perspective. Up until the 1930s it was fairly difficult for the average family to finance the purchase of a house. Mortgage loan terms required a 50% or more down payment with the balance due as a balloon payment in just three to five years.

No wonder only about 40% of U.S. households were able to own a home.[1]

In 1934 the newly-formed Federal Housing Administration (FHA) set up a loan program where people could borrow up to 80% of a property's value and take 15 years to pay it off. Since then loan terms have become even easier for homebuyers with less than 10% down and 30 years as the payoff term.

As a result, the rate of home ownership stands at 65.3% of all households,[2] with about 66% of those owing some amount on a mortgage.[3]

While purchasing a home has become part of the American Dream, many people believe that planning for retirement should include owning their house free and clear.

Does paying of your mortgage before retirement always make sense?

If you're taking your retirement seriously (and the fact that you're reading this is a good indicator), you know that investing as much as possible while at the same time eliminating as much debt as possible is part of a comprehensive plan for success.

Having adequate retirement income and low enough living expenses are both extremely important in attaining long-term financial security. In fact, if a person is paying high interest rates on their credit cards, it makes sense for them to temporarily adjust their lifestyle until they are free of this consumer debt.

While having a mortgage is seen as a more prudent form of debt than consumer credit, it's still a monthly expense and usually a significant one. So, as a rule of thumb, you want to have it paid off as you enter retirement, which may mean before the end of its 30-year term. However, this general guideline should not automatically override all other financial considerations.

Writing for U.S. News, wealth advisor Kristin McFarland lists a number of factors to weigh, especially if your plans to pay off your mortgage early will affect your ability to invest.[4]

Time horizon. If you plan to stay in your home long-term, it makes more sense to pay it off early.

Opportunity cost. If your mortgage interest rate is well below your average market returns, investing the money may give you a better return in the long run.

Life stage. If you are nearing retirement and have a lower risk tolerance, eliminating mortgage debt is a more conservative approach than sending that money into the market.

In general, getting out of debt (including a mortgage) is good. But it should be done as part of an overall plan that looks at your current needs, what's financially sustainable, and ultimately what most closely aligns with your best interests long-term.

Your trusted financial advisor can help you evaluate your options to come up with a scenario where you're in a prudent financial position for a successful retirement.

Sources:

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Important note: