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Prepaying Your Mortgage May Not Be Best Move

It seems like a no-brainer. If you can pay off your mortgage faster than planned, you should, right? The truth is, the experts are split on this one. Yes, there are great benefits to decreasing your debt, but there may be greater benefits from managing your debt well and investing elsewhere. Whether or not it is best for you to pay off your mortgage early may depend on several factors and your specific situation.

One reason you might not want to prepay your home loan is that you might give up great tax benefits. Jonathan Satovsky, an Ameriprise Financial investor recently told a New York Times reporter that people can earn more by keeping their mortgages and using their tax savings to invest. He used the scenario of a homeowner with a fixed rate mortgage at 6.25%. If that person qualified for the 20% income tax bracket, after he deducts his mortgage interest, the adjusted interest rate on his loan is closer to 4%. If the homeowner prepaid his mortgage, he would save that money each year, but he could likely earn more if he kept his loan and invested his tax savings.

“There might be periods where the markets go backward, and you think it’s a mistake,” he said. “But over 10, 15 years, they’ll earn a lot more by not prepaying.”

Another criticism of prepaying mortgages is that borrowers put themselves in greater financial stress while they try to make higher payments or more payments to pay the loan off faster. This might actually increase their risk of default of foreclosure.

Many mortgage loans also include prepayment penalties, punishing borrowers for paying too much in a certain period of time, or paying off the loan before the penalty term ends. If your loan includes this caveat, you should find out the details and how much extra you can pay in a year or how much you will be fined for completely the loan early.

Still there are plenty of good reasons to try to prepay your mortgage. “The goal should be to free up earned income so you can accumulate it for retirement,” said Gulfstream Financial Corporation chief executive Andrew Schweitzer in a New York Times interview. “If I’m paying $24,000 a year on a mortgage, I may have saved $8,000 a year in taxes. But if I didn’t have a mortgage, I would have saved $24,000 in overall expenses. It’s not rocket science.”

If you pay your mortgage faster, you could potentially save yourself thousands or even tens of thousands of dollars in interest payments. If you are disciplined you can use that savings to invest on your own in stocks and bonds or in other real estate. Plus, who wouldn’t love to be free of monthly mortgage payments?

Before you make a decision, try crunching some numbers with an online mortgage calculator. Most mortgage sites offer them, and they usually include a calculator that shows you how much interest you would save by paying one extra payment a year or by shortening your loan by so many years. You should also seek the advice of a trusted financial advisor to see if prepaying makes sense for your situation.