because money doesn't come with instructions

Inside Personal Finance

with RIC EDELMAN®

Before You Retire, Get a Mortgage

Think I'm nuts? Get back to me after you retire

The goal of retirement is to live in financial security. But that has nothing to do with being debt free. In fact, a big, long mortgage will work in your favor in retirement.

Think I'm nuts? Well, I'm not. What's really crazy is tying up hundreds of thousands of dollars in the walls of your house where that money can't serve you at all.

The truth is, the older you are, the more important it is that you don't have a lot of equity in your home. Think about it: When you retire, you are on a fixed income. You aren't earning a salary anymore, and your expenses might surprise you due to health care and long-term care costs. Even if you and your spouse are able to avoid medical expenses, you'll want funds to travel, make home repairs, support a charity or help send your grandkids to college.

Workers who suddenly need cash — to repair a roof, say, or buy a new car — can obtain a home equity loan or line of credit to cover that expense. But retirees often don't have that ability because lenders require an income stream that retirees usually don't have.

You can avoid this kind of problem by obtaining that mortgage before you retire (while you still have an income stream). For instance, say you were to get a new mortgage, taking $100,000 out of your house's equity. That would give you a monthly payment of about $700. The notion of getting the use of a hundred grand is enticing, but how will you pay for that $700 monthly bill? From the $100,000 you borrowed, that's how! After making your first payment, you'll have $99,300 left. See the point? Even if you earn no interest at all, you're able to make payments for years and years — and all the while, that money is ready and available to you in case you ever need it.

And, of course, until you do need it, that money can be invested where it can grow. If you're able to leave the mortgage proceeds untouched and invest it for an 8% annual return, your $100,000 account would be worth nearly a third of a million dollars after 15 years. Clearly, a mortgage can help you create wealth in surprising ways!

There are tax benefits to investing this money as well. Assume you have a 6% mortgage and earn the same amount on your investments. Is it a wash? No, thanks to current tax law: The money you spend in mortgage interest is deductible at your top tax bracket, but the profits you earn on your investments are taxed as low as 15%. If you're in the 25% tax bracket, this means your mortgage costs 4.5% after taxes, while your investment nets you 5.1% after taxes. In other words, tax law helps make it beneficial for you to have a mortgage.

Of course, this strategy isn't suitable for everyone. If you don't have the discipline not to fritter away the $100,000 on a new television, vacations and other non-essentials, you shouldn't get a new mortgage. The same is true if a mortgage payment is going to keep you awake at night.

But over the years, I've encountered many people who would have benefited from holding a mortgage during retirement. Recently, I took a call on my radio show from a man whose 85-year-old mother was suffering from dementia. His sister has been staying with Mom 24/7 for the past two years, fulfilling Mom's wish to stay in her own home until she dies. Although the family wanted to hire full-time care for Mom, her only asset was her $700,000 house, which she owned free and clear.

Now, $700,000 can buy a whole lot of homecare. But not if you can't access it — and she couldn't because she didn't have a mortgage. Selling the house wasn't an option because Mom didn't want to move.

This problem is so common that an entire industry of "reverse mortgages" has emerged to help similarly house-rich and cash-poor seniors. Unfortunately, reverse mortgages have problems. First, there are limits as to how much you can borrow, and the amount often is not as much as the borrower needs. Second, closing costs, fees and interest rates for reverse mortgages are very high — if you die or move out of the house within a couple of years, you'll wish you didn't obtain that type of loan.

I'm not alone in my concerns about reverse mortgages: The Financial Industry Regulatory Authority has issued a warning urging seniors to carefully weigh all their options before obtaining a reverse mortgage. FINRA says reverse mortgages are being aggressively marketed as an easy, cost-free way for retirees to finance their lifestyles or pay for risky investments when these mortgages can actually jeopardize their financial future and therefore "should generally be a last resort" for those in need of extra cash.

In other words, if you think you'll need to get the equity out of your house in the future, do it now via a conventional mortgage rather than later through a reverse mortgage.

While the idea of a mortgage during retirement is counterintuitive (and opposed by many self-proclaimed gurus who don't understand the benefits of mortgages), it's actually a very smart strategy.

Remember that you'll always be happy that you have ready access to money when those unexpected expenses come up. Because despite your best planning, something will come up. It always does.

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