



Making the Most of Your Money by Susan Carr-Templeton 8/10/10

Pay Off Mortgage Early - Earn Money On Cash



If you're in a situation where you have an emergency fund and feel frustrated by the low interest rates banks are paying on cash right now, I have a new option for you.

With an emergency cash fund, what should you do with your extra cash? You can pay off some of your mortgage early. While you'll lose the mortgage tax deduction, you can earn more on your cash by paying off your mortgage early than you can by buying a certificate of deposit (CD).

Rather than let your cash sit around earning 0.25 percent in a money market fund or 0.1 percent in a one-year CD, while at the same time-paying 5 percent in mortgage interest, use your cash to **pay down some of your mortgage.**

Here's an example:

- You're in the 35 percent federal tax bracket and 3 percent Illinois bracket
- Your current mortgage rate is 5 percent

Prepaying your mortgage will essentially earn you a 2.5 percent tax-free rate or 4 percent-taxable equivalent return. And if you're subject to the alternative minimum tax (AMT), as most of us are, that tax-free return will even be higher.

Here's the math so you can plug in your particular calculations. Run a quick scenario of what your taxes and net income would be if you paid down a portion of your mortgage and if you did not. Be sure to include the added income from the return of that money if you chose not to pay down your mortgage and invest it in a one-year CD earning 1 percent. Take the difference in the net income between the two scenarios and divide that by the amount you would have used to pay down the mortgage.

In the scenario above, that was a difference of \$4,960 on a \$100,000 income where \$200,000 was used to pay down the mortgage.

A note of caution: You should **always keep some cash on hand for emergency and unplanned needs.** It is your cash beyond your emergency fund that you want to consider for this analysis.

And finally, this is a "back of the envelope" calculation, so be sure to consider any other aspects that may affect your personal taxes.



[Susan Carr-Templeton](#) is a personal wealth advisor with more than 20 years of investing experience. In addition to managing Stafford Wells Advisors, Susan volunteers on the investment committee for the Advocate Foundation.