Retirement Hacks

Should you get out of debt before you retire? Here’s what you need to know

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There’s good debt and bad debt, and calculations to make before retiring with either


Consider your options with debt management before you retire. GETTY IMAGES/ISTOCKPHOTO

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For most, debt is unavoidable during at least one point in their lives – whether it should be in retirement, however, is highly debatable.

There are two types of debt: “good” debt and “bad” debt. Broadly speaking, good debt is for necessary, reasonable purchases that will improve your life, such as a low-interest debt for higher education, an affordable home or car. The latter is debt with high or variable interest rates that is used to purchase discretionary items or things that lose value quickly. Credit card debt is often an example of bad debt. Many Americans may think they need to pay off all of their debt before retiring, but that’s not necessarily true. It comes down to the type of debt, the interest rates and whether or not the repayments fit into a retiree’s fixed budget.

“There are a lot of misconceptions about debt and retirement, largely stemming from times when interest rates were far higher than they are at present,” said Joel Cundick, a certified financial planner at Savant Wealth Management. “While high-interest rate debt, like credit cards, should certainly be eliminated before retirement, other forms of debt can make sense.”

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Repayment should not cost someone their retirement savings. “I have seen people who pay off their mortgage, but then have very little savings left for retirement,” said Michael Strohl, a certified financial planner and partner of Open Advisors. “They become debt-free, but severely cash poor. There is a balance that should be reached.”

A mortgage is one of the largest debts a person will have, and not everyone can pay it off before they retire. “If individuals and families are less than three years from retirement and a mortgage balance can feasibly be paid off prior to retirement (like with excess funds that used to be going toward college education expenses for children), then that can remain a good strategy,” Cundick said.

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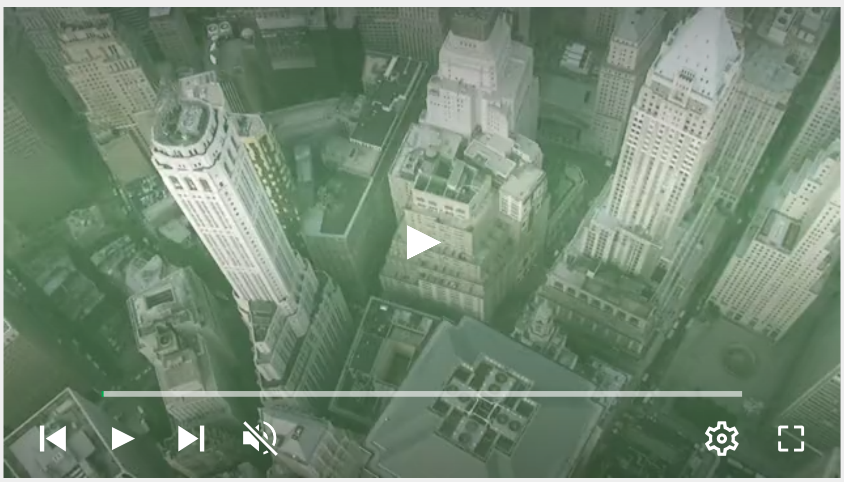

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When that’s not an option – that’s OK, too. A key factor in determining whether a mortgage is a reasonable expense to bring in retirement is the interest rate. Those who are near retirement and want to continue paying it into the golden years might want to consider refinancing their mortgages, if it will lead to a lower interest rate and lower monthly payment. “Getting the housing expense as low as possible at a fixed interest rate prior to retirement can make a tremendous difference in the coming years,” Cundick said.

There are other options for managing debt: consolidating credit cards and taking advantage of 0% offers to pay down consumer debt quicker are two, said Katarzyna Marczyk, a certified financial planner and chief executive officer of Anchor Wealth Group.

Debt can be a “tool,” financial advisers said. If you take on a little debt and can manage it, money that would have otherwise gone to paying off the mortgage or auto loan completely can be used to grow in investment accounts that exceed the interest rates for these debts.

“Why pay off a mortgage at 3% if your money is earning 6%, 7% or even 9%?,” said Todd Smith, a certified financial planner and chief executive officer of Level 5 Financial. Consumer debt typically has much higher interest rates, and should be managed prior to

Consumer debt typically has much higher interest rates, and should be managed prior to retirement – that is, creating some sort of budget to keep expenses under control, sifting between wants and needs and avoiding impulse purchases that bring the individual or family no real value or joy.

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Still, this path is not for everyone – and having debt in retirement doesn't always make financial sense, either. Part of the decision comes down to where the money to pay off these debts is coming from, said Nadine Marie Burns, a certified financial planner and chief executive officer of A New Path Financial. "If you have payments in retirement, you need money to make those payments," she said. "The more money you need, the higher your taxes on that income."

If repayments are coming out of a retirement account that is taxed at withdrawal, calculate how much you're paying in taxes and whether or not that strategy is worth it. For example, are these distributions pushing you into a higher tax bracket, thus forcing you to pay more in taxes? Is it possible to keep withdrawals low and still pay off the debt?

Consider what withdrawing extra cash during market volatility will do to the potential growth and longevity of portfolios too, Burns said.

This stress can be minimized by understanding cash flow before retirement and making thoughtful, and well-researched assumptions about expected cash flow in retirement. Think of every possible expense, and plan for an emergency savings account to avoid

dipping into your retirement funds. Understand where debt repayments fit into that budget. If an individual has a reasonable interest rate and monthly payment for a mortgage or auto loan, and sees through a budget that he or she can still spend on necessities while having excess income to use for recreation in retirement, debt may not be as much of a stressor.

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