



Cash is King?

Cash gives options, but prepaying mortgage helps take back control

By Ilyce Glink
and Samuel J. Tamkin
Tribune Content Agency

Q: In your columns, you often take the position that homeowners are best off prepaying their mortgage. I understand where you are coming from and admit that I used to counsel my clients the same way. No longer. I now believe that “cash is king.”

After watching the difficulties my clients had after the last economic downturn, I urge my clients to build up cash reserves and only prepay the mortgage when it is compelling to do so — say, at retirement.

A: We can agree with you that cash is king, but you must have that cash to be king. For many Americans that don’t earn enough to pay their monthly expenses, have problems budgeting, run up credit card debt, or are derailed by a medical emergency, getting a better handle on their finances will be crucial to reducing financial stress.

One good way to take back control of your finances is to prepay your mortgage.

We’re not saying that prepaying a mortgage is right for everyone, but what we are saying is there is a large segment of our readers that will find prepaying their mortgage far more advantageous than having the cash in hand.

Consider that over the last 20 years many homeowners refinanced their home loans and used the funds from the refinancing to buy cars, make both necessary and unnecessary

additions to their homes, buy more stuff and take exotic trips. These people enjoyed their money at the time but are now paying that cash back (with interest) over the next 20 to 30 years.

If you’re a baby boomer (born 1946 to 1964), you are going into your golden years with an enormous amount of debt, very little equity, and very little retirement savings. More of your Social Security payments are being used to pay for Medicare and supplemental health insurance costs. You may well wish, once you hit your 80s, that you were long done with paying your mortgage (and, in some cases, remaining student loan debt).

We believe in flipping the wheel. While it’s fine to enjoy some of the extra cash you have today, there is a balance to spending money for “now” and saving money for “tomorrow” and retirement.

Yes, the last downturn was hard on people short of cash, but for those people that paid down their mortgages monthly, their mortgage debt declined substantially over the time they owned their homes, especially if they refinanced to get even lower interest rates. When times got tough, they could elect not to prepay their mortgages in those years and use that extra money for essentials.

Many people that got into trouble during the Great Recession had purchased homes that outpaced their incomes and did cash-out refinances to then spend the money on other

items, including buying investment properties. Bigger homes cost more money to heat, cool and maintain, so the unexpected costs added up quickly.

If these people had a large amount of cash on hand, they could have survived the Great Recession in better shape, and perhaps wouldn’t have had to tap 401ks or liquidate all of their other investments. You’re assuming, of course, that they wouldn’t have misused cash to buy consumer goods, take expensive vacations, buy homes that they could not afford, etc. And if they didn’t spend their savings, you’d probably be right.

The truth is, many Americans were out of work for years in the Great Recession, or they were forced into taking part-time jobs that didn’t have any benefits. That’s extremely tough to manage financially. And we know very few who would have been able to save several years’ worth of income, and then keep those funds in cash.

You’re absolutely right that having some cash on hand is extremely important. But so is knowing how to invest it (so it’s liquid), manage it, and plan for the future. We like the idea that prepaying your home ensures that your home will be paid off sooner, giving folks more money to spend just as retirement hits or on nonessential luxuries if the proverbial “ship comes in.”

If nothing else, cash gives you options. And, that we love. Thanks for your comment.