EPISODE 1166

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FT: Happy Friday, everybody and welcome to So Money. I'm Farnoosh Torabi. We're going to kick of the show today with answering a very popular question, that is so popular, I just wrote an article about it and called it a day. I'm going to share some of that with you. The question is, maybe you've asked it, "Should I pay down my mortgage early?" I've had this question myself. I've actually come to the conclusion that at my life stage, in my 40s, assuming that I have other financial boxes checked, that it would not be a bad idea to put a little extra towards my principal. I don't want to be one of those borrowers that has a mortgage into her late 60s. That doesn't sound very fun to me, and I have a 30-year mortgage that I took on last year. It's important to me to be somewhat debt-free by 60 and I don't have any other debt, so it would just be this mortgage.

I wrote for Bloomberg which is behind a paywall and that's, I admit, it's kind of annoying. I wanted to share some of my thoughts on this. Just so you know, a lot of people are taking on mortgages right now. New home sales reached a 14-year record in 2020. The pandemic and incredibly low interest rate drove the buying frenzy. I was among the buying cohort. We bought a new home in the suburbs and the trend is continuing into the new year. The National Association of Realtors says that in January alone, guess how many new homes were sold in January? 6.7 million. Now, just to put that in perspective, compared to January 2020, that's a 23%. A house, two doors down from me, maybe three doors down went on the market earlier this year and got 20 offers, my friends. Twenty offers sold for 40% above asking.

We have a listener later in the show who's asking, "Is it a good time to buy?" I've got some thoughts on that. But as far as paying down your mortgage, if you were one of these millions of people who took on a mortgage last month or in, at any point during 2020, some advice for us. I think it's a compelling argument to pay down your mortgage, But I think it comes with tradeoffs. And unless you are someone that just has oodles of money in the bank and you've done all the things, including, you've bulked up a rainy-day reserve, you've maxed out your retirement account and then some. You spoiled yourself a little bit that year, because it's important to treat yourself smartly with your money. You've put money into the 529, you've done any home improvements that you want to make and you've got some money left over and you're looking at that mortgage. Sure, put a couple extra payments one or two or more towards the principle that can help to alleviate the interest burden over time, knock down the term and just get you out of debt faster. I mean, there are books on this. *Automatic Millionaire* by David Bach, who's been a guest on the show several times, is all about the power of paying down your mortgage early. But it only really works I think if you got other things "taken care of."

In this article, I really focused on what those priorities should be and I kind of tease them already. But number one, bulk up rainy-day savings. Before setting sites on mortgage zero, check your rainy-day funds. Because here's what, if you lose your job tomorrow, it is going to take an average of 26 weeks for you find another job. That's what the labor department is currently reporting, that the "unemployment duration" or the length of time it's taking for someone who is receiving unemployment insurance currently to begin a new job is 26 weeks. Do you have an emergency account that say 26 weeks, or 6 months, or 7 months, or 8 months? Because that is on average what you're looking at in that kind of a worst-case scenario. But there are other worst-case scenarios, right?

There could be like a situation where you just can't take your job anymore, you just can't. You have to take a leave of absence, whether that's because you have to take care of family, or you have to take care of yourself, or you just hate the job so much, you need time to find a new job and leave. You're cutting your loses and you're like, "I'm out of here. Got to find a new job." You need to afford yourself options, which we talk about on this show all the time.

Rainy-day savings in my book is of higher precedents, higher importance than knocking down your mortgage. Which by the way, if you got a mortgage in the last month or last year, it's probably hovering around 3%, right? The 30-year mortgage, assuming you had a good credit score, strong credit score and all the other factors checked off, that you got something like 3%. The average 30-year fixed rate right now is about 2.8%. Mathematically, it then make a lot of sense to pay down a 2.8% debt when you have other important things to tackle, like your rainy-day, which could if you don't have it, kick you back into credit card debt. Which is carrying a bigger than 2.8% interest rate.

Number two, up your retirement contributions. It's not secret again looking at the math, that money in the stock market over the long haul offers a better return than paying down a mortgage with that 3% or even 4% interest rate. Which if you have a 4% interest rate, you really need to think about refinancing. Then if you've got kids or you are about to have a child, I would even put a 529 college savings plan higher on the list than paying down the mortgage. If you've got limited money, we have to make choices. If it's between saving for college or paying down your mortgage, I think college, depending again on what your goals are around affording college for your kids, it might make more sense. If you're the kind of family that's like, "We're going to just kind of go 50-50. We pay 50%, our child pays the other 50%, or I want to do the whole thing or we're just a public-school family versus private school, right? Kind of know what you want to contribute to as far as that college experience. Do enough there as far saving ahead of time, and there are calculators online. Then if there's money left over, boom, pay down the mortgage.

But before you pay down the mortgage, last step, if you're there, you've done all these other things. Look at your interest rate on the mortgage. Is it more than 3.8% or 4%? You haven't refinanced it at all since you've got the mortgage maybe a few years ago or longer than that, you might want to consider refinancing. I know this seems like a step in the opposite direction, because refinancing effectively resets the payoff clock, taking on a new 30-year mortgage when you maybe you already like eight years into your previous mortgage. But hear me out, if you've got really good credit, which means mid to high 700s for the score, you could qualify for the 2.8% that I was talking about earlier.

If your monthly savings from that lower interest rate is going to eclipse any upfront closing costs in a few years, this could be very well worth your time. You can run your own calculations online. If the answer is, “Yes, this makes sense.” Then you could take the savings from this new mortgage and apply that to the balance. See how I did that. You don’t have to come up with any new money really or this pay down. You basically refinance your mortgage, took out the savings from the refinance. This will happen right away because you’ll have closing costs, but eventually, you’ll have pure savings. That’s the money you can use to help knock down the balance. That’s the bottom line. You can pay down your mortgage early if you want, you’ve got my blessing, but please don’t do it until you have achieved these other financial goals. Full article at Bloomberg Opinion.

Switching over to our review section on iTunes. I’m so grateful for all of your support. I have to say, going out on a limb and sharing my opinions about someone as powerful as Dave Ramsey, a white male, powerful figure in the personal finance space, I understood there were some risks for me. Okay? Let’s be honest. I definitely felt some backlash, I definitely experienced some backlash. There was somebody who left a very unfriendly review. There are people who said nasty things on Instagram privately, of course and also publicly on my feed, but that’s fine. I was talking with my mother about it over the weekend, she was like, “Good. That means you said something that was important, that had meaning. You weren’t just sort of saying something that was feeding an echo chamber.” Thanks, mom for that pep talk.

But I really feel strongly about the fact that you should not, especially if you’re in a position of power and you’re giving financial advice to do that in a way that makes people feel shamed, or guilty, or more insecure. Like, who do you think you are? I just had to share my piece. Thank you for everybody, most everybody who was extremely understanding and shared your own thoughts on this. Apparently, this unlocked, unleashed a lot of people’s own issues around this type, this brand of financial advice. Dave Ramsey is not the only person who does this, there are many others. And my point is to say, there is an entire universe of incredible financial pros who are way more inviting, engaging, inclusive, understanding, empathetic, all of whom have been on this program. All you have to do is literally listen to this podcast.

People have said, I’ve learned about so many other financial experts. Thanks to you. Thanks to your show. That’s what I’m here for, because this is a big job. I’m not the only one who can do it or should do it, frankly. There are many other voices that need to be heard and need to be amplified. With that, going to the reviews section, I'm going to pick a reviewer of the week. This person is going to receive a free 15-minute money session with me. This one is going to go out to Sarah Kernoles. It's funny and I don't know if this is your situation, Sarah. But in the past when I have shouted some of these reviewers and have called out their names, their like nicknames. They're like, "I didn't even realize that was my nickname. I forgot all about it. I signed up for iTunes in 1999 or whenever it was" — not even. Was that impossible? "2005 and I had a double take when you called my name out.

Sarah Kernoles, your title for your review is, Calm, Educated Strong Voice in the Money Space. She says, "What a gem. After listening to the podcast, I feel empowered and confident. What more could you ask for? Money can be so confusing and broad, and Farnoosh breaks it down so it is easily understood and actionable. It is well researched and the various guests provide different perspectives to look at money in new ways. I love all the diverse perspectives and wealth of knowledge that is shared, especially Ramit Sethi and Erin Lowry. They gave her the recent Dave Ramsey perspective. They gave a voice to some issues I've had with his advice. It goes to show how important it is to find mentors with whom you personally resonate. There are all kinds out there and it is not one-size-fits-all." Couldn't say it better myself.

Sarah, thank you so much. Get in touch with me so we can chat. You can direct message me on Instagram @farnooshtorabi. You can also email me, farnoosh@somoneyypodcast.com and go on the website, So Money Podcast and click on Ask Farnoosh. I encourage all of you if you have yet to leave a review, if you have thoughts about the show, please do so and we could connect, you and me on the phone. I do voice to voice. There's no need to put on like a nice shirt and comb your hair. This is just voice to voice. Remember those days when you would just hear someone's voice? I mean, I guess, this is what we're doing right now, right?

[ASK FARNOOSH]

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FT: Let's head over to the mailbag.

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Our friend, Sage writes in and she asked,

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S: "Hey, Farnoosh. I'm considering putting my mortgage into forbearance. President Biden just extended it for six months and I haven't lost my job and I just refinanced the house, but money is tight and I have been able to rent out rooms in my house due to COVID uncertainty. I like the idea of pausing the payments so that I still have a cushion and I'm not dipping into my emergency funds or my paycheck to cover the monthly payments. But I'm concerned about what happens when the forbearance period ends. What do you think?"

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FT: All right. You're right to be curious about what happens, because what happens may be different depending on your bank. The general approach to mortgage forbearance from the banks is that they will pause your payments, there's no extra that you have to pay. But when that forbearance period ends, six months from now, you have to start paying it back. Do you have to start paying it back right away over a period of time? That's what you really want to find out. Call your bank, talk to somebody, write down their name, record the call, whatever you've got to do to just be sure that you are both aligned as to what is supposed to happen.

Because not to scare anybody out, there has been some confusion around this. It was mostly in the beginning, back in the spring of 2020 when this mortgage forbearance was just being introduced in response to COVID and the banks were scrambling to kind of come up with their own method. Consumers were complaining that it was impacting their credit scores. I've seen a lot of the complaints myself. I did this whole story on it. But I think a lot of that has ironed out, but you still absolutely need to know what is going to happen, because it's not the same thing at every bank. Because the risk that you potentially run is that whatever the plan is that the bank requires of you, the repayment plan, that may be too much for you to take on, so call your bank, understand what your own banks rules are around this forbearance, what kind of repayment is expected of me, when does that begin and see if there's flexibility. Could we stretch this out even further?

If they're like, "Well, you got to repay it over the next year on top of the actual mortgage that's due during that year. You have to pay these back payments." That could be a lot for you and so see if there is any flexibility with that. Again, I don't know what the rules are but I'm just speaking hypothetically. If that is the case and it's too strict for you, maybe you could ask for something more flexible.

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Next up is Valerie and she says,

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V: "Hey, Farnoosh. I just graduated from college in May."

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FT: Congratulations, Valerie. My heart goes out to all the seniors, high school seniors, college seniors that spent their last year, maybe you did out of your classroom, at home, or in your dorm room or in your apartments, going to school virtually. That was not the experience you are expecting. I hope you are still able to make something of the year. You did graduate, so that's a huge accomplishment. Our question is this,

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V: "I was hoping that the housing market would take a nosedive, but it seems stronger than ever right now. I'm currently renting, but I'm looking to buy. I plan to stay in the area that I'm in for another 5 to 10 years. I would keep my budget for a home to be the same monthly price, give or take, a hundred dollars or so. Is buying right now a good idea?"

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FT: Okay, big breath. In your case, Valerie. I would say, hold off, especially if you're seeing in your area people bidding up homes like there's no tomorrow. I, like you expected this year to be a little bit of a cooling-off. If anything, it's been double the heat already. In January, we're seeing crazy, crazy, at least in my town. This could be different where everybody lives, right? But in my town, where you live, Valerie, it sounds like, the market has done nothing but get hotter. We're seeing prices mimic what they went for in 2006. Remember 2006, 2007? What happened? Prices went through the roof at the bubble burst. The bubble burst big time. So much so that the people who bought in 2006 who are now trying to sell in 2021, they'll be lucky if they get the 2006 purchase price. I'm looking at my neighbor's house right now. I don't think they listen to this podcast, but I saw what they paid for their home in 2006 and their home is going on the market and time will tell.

But my money is on the fact that they might break even, they might. I mean, they're not even going to really breakeven, right? Because even if they sell it for what they paid for, that's 15 years of taxes, 15 years of maintenance. It's not really like they're going to walk away with as much money as they started. They're going to walk away at a loss. They need to make a lot more essentially, effectively to really make this an "investment." But we don't look at primary homes an investment, but I'm just saying that right now, people are paying for homes prices that we haven't seen in 14 years. If you have time and you're not in a rush, because you're not rushing into a town that has schools that are functioning, that is out of the city because the city is not a great place to be in during a pandemic. There are reasons people are making these moves and it is with a sense of urgency and I get it.

I have very good friends who are looking to buy in our town. I get it. I'm not discouraging them because they are in it to win it. They're like, "We're coming, we're staying for the next 20. Well, this is not a flip for us. I know we're going to probably pay more than we should, but it's also still cheaper than New York City." In that case, they can afford it, they know what they want, they know what they're getting themselves into.

You my dear just graduated from college. This is not a time to be jumping into a hot housing market. Hot for the sellers, not hot for the buyers. And you have time, as you said, you have 5 to 10 years to work your way into this town. A life could change, you could decide not to live in this place next year or five years from now. To set yourself up for success, Valerie, you continue to save, you continue to educate yourself on the market. Something great might come up. But I think right now, generally from what I'm hearing from you, this is not the right time for you. I know that I've said on the show that you should just make a decision based on what you need and not so much with what's happening in the market. I'm applying that hear.

I'm saying, what I sense from you is that you don't need to be doing this. There's not really like a sense of urgency or need. Additionally, the market is not that great. For two reasons, I would say don't do it. But then you might be the person like my friend, who's really ready, who got her financial ducks in a row, who is moving here, and wishes she was here yesterday because she wants to get her kids in public school, and they want to get more bang for their buck. Makes sense. I know the market is crazy, but there are other costs to waiting for that. There's the cost of staying in New York City, which is something that they definitely don't want to do. It is complex, but in your case, Valerie, my thinking is, hold off, save and maybe email me again this time next year and let's see where things are. Because I thought like you too, things are going to get a little less crazy, but they have not.

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Let's see, where are. We've got a question from Amy. It's about her divorce. She says,

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A: "As part of my divorce settlement, I received a 401(k) in the amount of about $130,000 from my ex's employer. We live in Colorado and according to Colorado law, I'm entitled to a one-time cash out without a penalty. I have managed to avoid cashing out the 401(k) so far. I very much hope not to, but I do like the peace of mind it gives me, knowing that I could if needed. I have emergency savings of about $10,000 and I hope to grow that to at least $30,000 in the next few years. I started a business about two years ago and while the pandemic slowed down my growth. I still feel confident that I will be able to grow to the point where it will support me and my family by the time I ex's maintenance payments run out in fall of 2023. So far, I've been focused on slowly but surely building up my emergency savings, but now I'd also like to start contributing to retirement and opening up college savings accounts for my kids who are 11 and 8. I'm thinking about opening up a Roth IRA. Is there any advantage to rolling the 401(k) into a Roth IRA or do you recommend leaving it in the 401(k) just in case I do need to cash it out? Maybe at least while I'm building up my emergency savings and growing my business, I am pretty much able to live solely on my husband's maintenance payments and child support. So any profit I make in the business until 2023, I can save."

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FT: All right, Amy. Several questions here, I'm going to go through this step by step. Let's first talk about this 401(k) that you got in your divorce settlement. That's about $130,000. I would not tap this just yet. Many of us in 2020 if you read through the CARES Act had the opportunity to tap our 401(k)'s penalty free in the event of a COVID-related financial setback. My advice then to everybody was, do this if you absolutely had to because your house is on fire. When your house is on fire, you don't question the cost of the water, you use the water. It doesn't sound like your house is on fire, Amy. It sounds like you're able to live comfortably off of the child support, off of your husband's maintenance. Your business by this time next year could be making some profit. That's going to be nice extra money.

I would do this. I would talk to a financial advisor. You could even just call up wherever this 401(k) is sitting, talk to an advisor at that firm and be sure that how this money is being invested make sense for you. This money came from your husband's 401(k), presumably, right? And maybe you were, were not involved in that portfolio's design. Now that this is yours and for your retirement, you really need to know how much of this money is being invested in stocks versus bond, how much of it is sitting in cash. Are you comfortable with that mix? That is also where you can talk to someone about perhaps rolling this into a Roth IRA or a traditional IRA, and you can continue to contribute to that. But really important to have an expert step in here to tell you whether this 401(k) is appropriately designed for you and what the best way to manage it is should you roll it into these vehicles.

But I don't think it sounds like you need to be tapping this out right now and you might want to hold off about rolling it over like you said to another IRA until your business is up and running, and you've got some positive cash flow. Because if this time next year you are in a different place, it would be nice to have access to this 401(k) and not pay that 10% early withdrawal penalty.

As far as college savings for your kids, you should talk to your ex about this as well and I'm going to recommend a book for you. It's called, *The Price You Pay for College* by Ron Lieber. He was on this show, maybe you listened to that episode. We didn't get into the dynamics of how single mothers and single parents should talk to their exes about affording college, and how it should work, and how it could work as far as becoming eligible for government loans, but something to talk to him about. Hopefully the lines of communication there are still good and you can come up with a plan together. But a 529 is a great place to start and as I said earlier, how much to contribute back when I was talking about whether or not to pay down your mortgage, I talked about the 529. I think the considerations for families as far as how much to contribute to a 529, you got to ask yourselves, "Okay. What are we going to contribute? If we know the colleges is going to cost X by the time our son or daughter goes to school, how much of that do we want to contribute?" Also, keep in mind that you don't always pay the sticker price. A lot of times kids do get merit aid, they can qualify for grants, you might get a really affordable government loans, so all of that can factor in. Are their grandparents that can contribute?

Your burden or your cost is not going to be as high as you might right now think, because you've thought about these other scenarios. I would definitely start contributing to your own retirement. Having that six-figure cushion is very nice, but it's not going to be — but you're going to need more, I would assume, right? In retirement, that going to go very, very quickly. Starting something additional to that or eventually rolling it over and contributing to that one pot is not a bad idea. As a business owner, I talked about it on the show many times, the SEP IRA, you can't beat it. I have one, the Simplified Employee Pension Fund is designed much like a traditional IRA in the sense that you contribute from your business proceeds to this retirement account for yourself. Contributions will be deducted from your taxable income and you can contribute a lot more than you can to a traditional IRA. I believe in 2020, the contribution limit was $57,000. That's significant and you don't have to do all of that, but it's nice to know that you have up to that much money that you can contribute and then deduct from your taxable income. It's a huge tax savings vehicle.

It doesn't sound like your house is on fire right now, Amy, that you can kind of make do with what you have. Keep the money in the 401(k) until you've had a conversation with somebody at the firm to talk about your options, but most importantly to know how the money is being invested in that 401(k). Then I would revisit it in about six months to a year, taking into account how well your business might be doing. If it's doing really well, you may not have to keep it in the 401(k). You can roll it over, not worry about having to access it and missing out on that penalty free provision. That you can just roll over maybe into that SE IRA that I talked about and start contributing to your own account now. Amy, good luck to you and thanks for listening to the show.

That's a wrap everybody. Remember to send me a question. You can go to Instagram, direct message me privately, you can tell me if you want to be anonymous. You can send me a question through the website at somoneypodcast.com or email me, farnoosh@somoneypodcast.com. Thanks for tuning in, everybody and I hope your day is so money.

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