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Bonus Cash May Benefit Homeowners by Making December 13th Month

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By Alexis Leondis



Dec. 22 (Bloomberg) -- Mortgage holders with cash from a bonus have a few days left to decide whether to make December the 13th month of the year.

Making a January mortgage payment in December for extra tax savings or applying a lump-sum payment to a mortgage balance may make better use of the money than investing in the stock market this year. The **Standard & Poor's 500 Index** is down 40 percent year to date.

"Paying down debt is a risk-free return," said **Greg McBride**, senior financial analyst at **Bankrate.com**. "Putting money in the

stock market certainly isn't."

About two-thirds of 450 U.S. companies are still committed to paying bonuses for 2008 performance, according to a Towers Perrin **survey** conducted in mid-October. More than half expect to pay smaller bonuses than 2007, the Stamford, Connecticut-based consultant said. Wall Street firms including **Goldman Sachs Group Inc.** and Morgan Stanley aren't paying any bonuses to senior executives and have reduced bonuses for other employees.

A lump-sum mortgage payment reduces the duration of the loan and total interest paid for homeowners with a fixed-rate mortgage. Monthly payments, however, remain unchanged. An adjustable-rate mortgage can result in a lower monthly payment at the next interest-rate reset, according to McBride, who is based in North Palm Beach, Florida.

Putting a \$50,000 bonus toward a 5.5 percent fixed-rate 30-year mortgage of \$500,000 that was taken out 10 years ago would save about \$84,000 in total interest, based on Bloomberg data. The loan would end almost four years early by making the pre-payment.

Tax Savings

Retirees and working people in the 35 percent tax bracket should assess their tax savings from deducting mortgage-interest payments before using year-end cash to pay down a mortgage.

"The deductions don't mean you want to keep a mortgage forever though," said **Burt Hutchinson** of **Fischer & Hutchinson Wealth Advisors LLC**, a fee-only firm. "You're still paying that dollar to the bank in interest just to get the 35 cents back."

Those in lower tax brackets may want to hold off on putting extra cash toward their mortgage because it may tie up needed funds. "Financial flexibility is at a premium right now and paying down a low-rate fixed mortgage doesn't offer much in the way of financial flexibility," McBride said. "That money is gone and you can't tap it."

Retirees may also be concerned about liquidity. They should avoid becoming “house rich and cash poor,” said Hutchinson, the fee-only planner based in Lewes, Delaware.

Paying off credit-card bills will generally yield greater returns than investing the cash elsewhere, said Steven Rogé, portfolio manager for **R.W. Rogé & Company, Inc.** in Bohemia, New York.

Reserve Funds

“Many credit cards charge north of 10 percent on any balances come month end. It would be better to take a guaranteed return on investment north of 10 percent than risk it in the equity or fixed-income market,” Rogé said. He added that paying off credit-card debt may also improve credit scores, helping qualify borrowers for lower interest rates.

An emergency-reserve fund, with enough money for daily expenses to last at least six months, should be created so it can be tapped if other sources of credit, such as credit cards and home equity loans, dry up, or in the event of a job loss, said **Jay Hutchins**, president of **Comprehensive Planning Associates** in Lebanon, New Hampshire.

Tighter Credit

“With credit tighter than it has been in recent history, a stash of cash becomes more important than usual,” Hutchins said. About 2.2 million Americans have been jobless for at least six months as of November, based on data released by the **U.S. Department of Labor** earlier this month.

Reserves in excess of six months may not be an efficient use of the cash because of the low interest-rate environment, said Jeffrey Zures, a certified financial planner at McLean, Virginia-based **Sanchez & Zures, LLC**. On Dec. 16, the Federal Reserve lowered the target for its overnight benchmark rate from 1 percent to a range of 0 percent to .25 percent.

“Over a long period of time, inflation may outpace the rate of interest you’re earning,” according to Zures, who said he is still seeing clients receive year-end cash bonuses even with the slowing economy.

Retirement savings such as 401(k) and Individual Retirement Accounts are other options for bonus cash received this year. The cutoff for 2008 contributions to 401(k) plans is Dec. 31. For IRAs, savers have until April 15. Ramping up contributions to retirement savings accounts is essential because of the tax advantages, McBride said.

People under 50 can contribute up to \$15,500 to their 401(k) plan and \$5,000 to an IRA in 2008. And for those thinking about year-end cash in 2009, the cap will increase to \$16,500 for 401(k) plans and remain at \$5,000 for IRAs.

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Last Updated: December 22, 2008 00:01 EST

