



MAKING CENTS

THE BRIGHT SIDE OF LOW INTEREST RATES



-John P. Napolitano, CFP®, CPA, PFS, MST, RLP®

When interest rates are as low as they are today, there are winners and there are losers. The winners are those with debt. Paying less in interest will never hurt anyone. But for those with no debt and a large sum of savings, earnings from interest income have never been lower. That said, overall, I believe that low interest rates can be good for the average person.

As one of the few forms of tax deductible interest, most people think that they need a mortgage to save taxes. While the mortgage interest may actually reduce your total tax bill, it still costs you something. If you are paying a 5 percent mortgage interest rate, and you are in a 25 percent tax bracket, your net after-tax cost for that loan is 3.75 percent. Are you earning more than 3.75 percent on your savings? If the answer is yes, then it makes sense for you to keep the loan. If the answer is no, then perhaps paying down on some principal is a good idea.

Looking at your higher interest rate loans such as credit cards and college loans could be quite beneficial in this environment. Instead of worrying so much about your home mortgage, look to eliminate these higher rate loans faster. In fact, it may be worth considering a new 30-year mortgage on the home just to free up cash through lower payments to extinguish these other more costly loans.

There are many out there with fixed-rate college loans in the 8 percent vicinity.

For those with savings earning interest, this environment has not been too delightful. Savings accounts and other short-term cash-savings vehicles are commonly paying less than 1 percent. To improve that, you must be willing to take more risk or tie up the money for a longer period of time.

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Start by looking for any “teaser rate” deals being offered by local banks. I see the ads from time to time where a bank may offer several percentage points above market rates just to get you to open an account. If you don’t mind having money all over the place, go for it and take their offer. Beyond teaser rates, consider some longer-term certificates of deposit.

For those with a longer-term horizon, but who are still not willing to take on much risk, consider fixed annuities offered by insurance companies. Many people think that annuities are only used for generating retirement income. While retirement income may be their primary objective, and tax penalties may apply for withdrawals before age 59½, it may be a better place to stash savings for a horizon exceeding 5 to 10 years.

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