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YOUR MONEY

# Mortgage or investment – use your lump sum wisely

**Louise McBride**

IT'S no secret that many of us are broke after five years of austerity. But a lot of people in this country are filthy rich as well. Cash buyers are out in force in the property market — snapping up more than half of the properties that are up for sale. There's more than €90bn sitting in Irish savings accounts.

If you're one of those with a chunky lump sum at hand, you could be wondering what to do with it. With interest rates at all-time lows, you might want to do something a bit more productive with your money than to leave it sitting in a rusty old bank account. You've got a five-zero mortgage — as well as a five-zero nest egg. You're considering using your lump sum to clear your hefty mortgage. But would it make sense to do so?

### VARIABLE MORTGAGE

If you've got an expensive mortgage and have come into a big lump sum, it would make a lot of sense to use it to clear your debt — as you could save €100,000s by paying off your mortgage early.

Today's mortgages are a hell of a lot more expensive than they were six years ago, when tracker mortgages were still available.

If you're borrowing more than 80 per cent of the value of your home today, you'll be hit with a variable interest rate of around 5 per cent. At 4.8 per cent, Ulster Bank is the most expensive lender, followed by Bank of Ireland and EBS, who both charge 4.6 per cent. AIB charges 4.57 per cent while KBC charges 4.56 per cent. At 4.5 per cent, Permanent TSB is the cheapest lender — but this variable rate is still clearly very high.

Let's say you borrowed €200,000 last week to buy your home. If you're lucky enough to come into a lump sum of €200,000 shortly after you took out that mortgage, you'd save between €101,339 and €108,813 by using that lump sum to clear your mortgage, depending on your bank.

"For anyone who got a mortgage recently who is on an interest rate of between 4.5 and 5 per cent, without question it would make sense to use a lump sum to pay off their mortgage," said Ken Murray, director of the mortgage broker network the Association of Expert Mortgage Advisors.

### TRACKER MORTGAGE

If you snapped up a tracker mortgage before the banks stopped offering them in 2008, the interest rate on your mortgage could be as low as 0.75 per cent. The amount of money you could save by paying off a tracker mortgage early will be tiny when compared to a more expensive mortgage.

For this reason, it doesn't make much financial sense to repay a tracker mortgage early — unless you're expecting your financial circumstances to deteriorate.

For example, let's say you've got €200,000 outstanding on your tracker mortgage and you've 20 years left to repay it. If the interest rate on your mortgage is 1 per cent, you'll only save €20,652 by repaying it in full today.

If European interest rates start to rise suddenly, the tables will turn and tracker mortgages will become more expensive. However, interest rates are expected to stay at their record lows for at least another year.

"Interest rates are so low today; if you're on a cheap tracker mortgage, I'd hold off on using a lump sum to pay down your mortgage," said Frank Conway, founder of the personal finance website the Irish Financial Review. "You can deal with the threat of interest rates pushing up the cost of mortgage repayments later. If interest rates start to rise, revisit whether or not you should use your lump sum to repay your tracker then."

### INVESTING

You could make more money by investing your €200,000 lump sum than you would save by using that lump sum to repay a cheap tracker mortgage.

If you invest a €200,000 lump sum in a managed fund for 20 years, you could make €119,456 on your investment after tax — as long as your investment fund delivers a return of 4 per cent a year, according to Vincent Digby, founder of the financial advisers Impartial. So after 20 years, your €200,000 lump sum would be worth about €320,000.

This €119,456 investment return is almost six times what you'd save if you used your €200,000 lump sum to repay your tracker mortgage. For this reason, if you have a tracker mortgage, it would make a lot more sense to put your lump sum into an investment than to use the money to repay your mortgage — as long as you choose a good investment.

"In Ireland, the average balanced managed fund has delivered an annual return of 9.39 per cent after costs over the last five years," said Mr Digby. "This did, however, coincide with five years of strong equity market returns — which may not be repeated. There are a range of absolute return funds which have returned between 2 and 5.25 per cent a year over the last three years. These funds should be less volatile than directly held equities or equity funds."

Liquidity is another thing you'll have on your side if you decide to invest your lump sum. "If you need money, you can sell your investment and use the funds as you wish," said Mr Digby. "If, however, you repay your mortgage and need to borrow money after doing so, you may find that the banks are reluctant to lend and will only do so at higher interest rates."

If you have an expensive mortgage, there is unlikely to be much of a difference between the amount you could save by paying down your debt and the amount you could make by investing. Using your spare cash to pay down a 20-year variable mortgage of €200,000 could save you about €109,000. Investing €200,000 over 20 years instead could make you €119,456. In this case, you'll still make €10,000 more by

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investing your money — but as you are never guaranteed to make a return on an investment, it could make more sense to repay your expensive mortgage than to invest.

Similarly, if you have other expensive debt, such as a scary credit card bill or overdraft, it would make more sense to use any spare cash you have to clear that debt than to put it into an investment.

Remember, if you decide to invest a large lump sum, get independent financial advice. You will usually have to pay for such advice — but by doing so, you will have less chance of seeing your investment going belly up.

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# Keep a little by for a rainy day

IF you are about to lose your job or are struggling to keep your head above water financially, it would be madness to pour all your spare cash into an investment — or to use a lump sum to repay a cheap tracker mortgage.

Paying down an expensive mortgage would certainly be a step worth taking — but it is also important to have an emergency fund. Put your emergency money into a deposit account, which allows you access at any time — as well as paying an above-average interest rate. KBC Bank's Smart Access Demand account pays 2.3pc interest on savings of between €3,000 and €100,000.

"It's good to keep a year's salary aside as an emergency fund if you can," said Conway.

"People often underestimate their expenses and overestimate their earnings. You need to be prepared for rising costs in areas such as private health insurance, property tax and education.

"Banks are not lending so it is very hard to get a loan, if you unexpectedly need money. It's a good idea to set money aside for a rainy-day fund every month."