PERSONAL FINANCE

Extra Cash? Should You Pay Off Debt or Invest?

Depending on your financial situation, you might benefit from paying off debt, investing or both. Here are some things to consider before deciding.

When you have extra money, it can suddenly become a problem. Why? Instead of enjoying the windfall, you may face a difficult decision: Should you pay off your debts or invest the money? This is a valid question, and the answer may be: both.

Here's the thing: Investing is optional — you don't have to do it. Debt is a different story. If you don't pay it off on time, the interest adds up and your debt grows. With this big difference between managing debt and investing, the next step may seem clear. Before making any decisions, consider what it means to invest and what it means to have debt.

Investing

You've got plenty of investment options — stocks, bonds, mutual funds and more. Want to take it a step further? Consider investing in startups. Right now, industries like artificial intelligence (AI), health care and fintech are booming. Think of startup investing as financially backing an IT team that's creating an online banking system or a health care app that could lead to potentially serious returns.

However, you should know that the investment market, whatever it is, can be volatile:

- The stock market fluctuates all the time: One day you're up, the next day you're down
- Startups can go over budget early or demand might not materialize for the product

Having a solid investment management strategy is essential. And remember, investing is a long game. Seeing meaningful results can take three to five years or more.

Before you invest, consider first setting aside money in an emergency fund. This should be money in a separate account that will allow you to pay your everyday expenses for three to six months.

Debt payment

Did you know that your credit score can have a huge impact on your financial security? A good credit score (670 or higher) signals to banks, landlords and even employers that you are reliable and trustworthy. A lower score could mean you won't be considered for loans, rentals or even employment. Your credit score also can affect your insurance premiums.

Your credit score is based on how you manage payments on your mortgage, credit cards and personal loans (such as for your car) as well as the amount of credit available to you and how much you're using. A person who makes payments late, misses payments or stops paying altogether will have a much lower credit score. A person who makes regular on-time payments and has a lower debt load will have a higher credit score.

Interest rates on credit card debt are usually much higher when compared to what investment returns you could get.

Debt repayment vs investment: Which is right for you?

Here are some ways to manage extra money depending on your financial and personal situation.

For young families with children

Families who are balancing debt and future goals while also finding themselves with some extra money may benefit from:

- Paying off high-interest debt (over 6%)
- Investing a smaller portion of your extra funds (while also paying off debt) in growth-oriented accounts. These could be exchange-traded funds (ETFs) or tax-advantaged accounts such as 529 college savings plans to save for your children's education or a Roth IRA to save for your own retirement.
- By combining both options, you can reduce your debt while also looking to the future with peace of mind.

For people approaching retirement

As you approach retirement age, debt and investments need to be balanced with special care. Consider:

- Paying off debt from cash reserves or investments not tied to retirement savings.

- Using investments and/or savings to cover your living expenses to avoid early reliance on Social Security. Each year you put off claiming your Social Security benefits (until age 70), your check could be 8% higher.
- Getting a reverse mortgage. This option is available to people age 62 and older. To thoroughly understand the benefits and drawbacks of a reverse mortgage, you should discuss the concept with a financial adviser.

For singles

Even when you're the only one depending on your financial security, it's key to stay disciplined and consistent. If you have expensive debt — typically high-interest credit cards — start by paying that off. Explore options such as balance transfers or refinancing to lower your interest rates and make repayment more manageable.

Adding a side hustle can also be a smart move, giving you extra income to tackle debt faster while building financial security.

Last but not least

When you have extra money and need to choose between paying down debt and investing, everyone, no matter their personal or financial situation, should consider the following:

- **Adjustable interest rates.** Credit card debt often has a variable interest rate. That means that when the prime rate goes up, so does the rate on your debt. Usually, the new rate affects only debt that you acquire after the rate increase.
- **How you feel matters.** Paying off debt reduces stress and gives you a sense of financial freedom. For many people, this peace of mind can outweigh investment returns.
- **Compound interest.** This is when you earn interest on both the initial investment and any previous interest it has earned, meaning your money is likely to grow faster.

These are some of the considerations to think about if you find yourself with extra money and are trying to figure out whether to pay off debt and invest. You shouldn't take this article as a complete guide, though. It is best to seek the advice of an experienced financial adviser to make sure your money is working for you in the best way possible.

NYSUT NOTE: Put that windfall to work with advice from the NYSUT Member Benefits Corporation–endorsed Financial Counseling Program. You can get assistance on topics such as asset allocation, budgeting, and even general financial education. Don't hesitate to get help. There may be extra cash in your future.

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