

## Personal Finance

# Taking a 401(k) loan? Do the math first

Borrowing could cost you in the long run, so be sure to calculate the consequences.

By KATHY M. KRISTOF  
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Experts warn that taking money out of your 401(k) account while you're still working can cost you dearly later on.

Nancy and Charles Powell ignored that advice and borrowed money from his 401(k) plan. Years later, they're retired and have no regrets.

"We listened to a lot of people saying, 'Don't touch that,'" said Nancy Powell, 60, who lives in Bellingham, Wash. "But we borrowed out of it and we're retired and just fine."

Pamela Villarreal, a senior analyst at the National Center for Policy Analysis in Dallas, tells a different story. She and her husband borrowed from her 401(k) to make a down payment on their first home in 1993. She wishes they hadn't.

"We paid the loan back in about a year, but after we were done, we started looking at what we had lost by not having that money in the stock market," she said. "For us, it would have been smarter to have lived in an apartment for a couple of years and just saved for a down payment."

Financial advisors say the weak economy and credit crunch are likely to push more Americans to prematurely tap their retirement savings.

Statistics indicate that borrowing and so-called hardship distributions from retirement plans are creeping up, said Rob Reiskytl, senior consultant at Hewitt Associates in Chicago.

Either action can have significant long-term consequences, potentially costing the consumer hundreds of thou-

sands of dollars over time.

But as the experiences of Powell and Villarreal illustrate, the consequences aren't the same for everyone.

Most experts agree that taking a distribution from a 401(k) — withdrawing money and not paying it back — is so costly that it makes sense only under the direst circumstances, such as when you need the cash immediately just to keep a roof over your head.

Even then, first weigh every other option, such as selling the car, the baseball cards and anything else that's marketable, said Brent Kessel, chief executive of Abacus Wealth Management and author of "It's Not About the Money."

And be aware that taxes and penalties can eat up more than 40% of your distribution, Reiskytl said.

The expert take on borrowing from a 401(k) is not so clear-cut. In some cases, it's a financial disaster. In others, it's a powerful financial management tool.

"There are no universal answers," said David Wray, president of the Profit Sharing/401(k) Council of America in Chicago. "But before you tap the plan, you want to make sure that you've thought it through. Small decisions made today can have enormous consequences."

The Powells' experience shows when a 401(k) loan can make sense. They had gotten into serious credit card debt, largely because they helped their adult children with a series of financial crises. The couple went through credit counseling to get their spending under control but were being eaten alive by interest rates above 20%.

At the time, Charles Powell had \$27,000 in his 401(k) plan with Georgia-Pacific, and the plan allowed him to borrow up to half that amount at an inter-

est rate of 5.25%. They took out \$8,000.

Loans from 401(k) plans have two advantages: The rates are low — usually a percentage point or two over the prime rate. And your payments, including the interest, typically go directly back into your account after a small deduction for processing.

Even while they repaid the loan, the Powells were allowed to keep making contributions to their account, benefiting from Georgia-Pacific's 50-cent matching contribution for each dollar they put in.

In the meantime, the couple saved a small fortune on interest. That allowed them to get out of debt much faster than if they had left the 401(k) alone.

The Powells also had other pensions to rely on in retirement, Nancy notes. If they hadn't, they would have been far more reluctant to tap the 401(k).

Villarreal said her situation was different. She and her husband weren't in financial trouble, she said; they were just impatient to buy a home.

As part of her job as a policy analyst, Villarreal recently studied such loans and concluded that even a small one can cause a big loss in retirement security.

For example, a 35-year-old who borrows \$30,000 and repays it over five years could be \$193,000 poorer at retirement, assuming that he or she didn't make new contributions while repaying the loan and the 401(k) investments earned a 6.25% average annual rate of return.

If you assume a 10% rate of return, the loan would cost that 35-year-old nearly \$650,000 at retirement.

You can run your own numbers using a calculator on the research group's website at [www.ncpa.org](http://www.ncpa.org). Click the "Retirement Reform" button on



the home page.

"I just want to alert people to the true cost," Villarreal said. As for her husband and herself, she added, "We won't do it again."

Nancy Powell, on the other hand, isn't second-guessing the loan she and her husband took out. They might never have dug themselves out of debt, given

the high rates and fees that credit card companies charge troubled borrowers.

"We like how we live," she said. "I had all these papers that said what we would have had if we hadn't touched that money, but I don't think we're ever going to look."

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*Kathy M. Kristof welcomes*

*your comments but regrets that she cannot respond to every question. Write to Personal Finance, Business Section, Los Angeles Times, 202 W. 1st St., Los Angeles, CA 90012, or e-mail [kathy.kristof@latimes.com](mailto:kathy.kristof@latimes.com). For past Personal Finance columns, visit [latimes.com/kristof](http://latimes.com/kristof).*