THE FINANCIAL CREST'S GAZETTE

THE OFFICIAL BLOG OF FINANCIAL CREST

USING YOUR 401(K) FOR BUYING YOUR FIRST HOME

LOAN OR WITHDRAW?

WRITTEN BY
GOPALAKRISHNA MAHESH
CHARTERED ACCOUNTANT, CPA

- Buyers can access funds from their 401(k) through a loan or an outright withdrawal.
- Outright withdrawals from 401(k) funds incur significant penalty and tax expenses.
- First-time home buyers often consider using 401(k) funds to buy a home when they don't have enough savings for a traditional down payment.
- Most financial experts advise against using 401(k) funds to pay for a home.
- There are flexible home loan options (like FHA and other first-time buyer programs) that enable people to buy homes with very low down payment requirements.

IN THIS ISSUE, WE'RE COVERING:

401(K) FOR FIRST TIME HOME PURCHASE

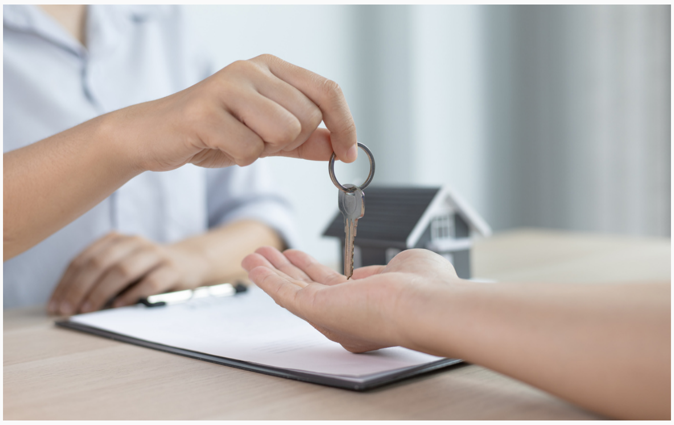
401(K) LOAN
SHOULD YOU TAKE AS A LOAN?

When you take out a loan from your 401(k) account, it works like any other loan with some specific parameters. Most 401(k) plan providers require that borrowers pay the loan back within five years. You'll also have to pay the loan back with interest, although the obvious benefit is that you will pay it back to yourself.

Going the loan route will also avoid the 10% early withdrawal penalty (given to anyone who withdraws funds before age 59½). It also won't impact your credit report or your debt-to-income ratio, both significant benefits for people with low credit or who don't want their credit affected for other reasons. The maximum amount you can borrow from your 401(k) is $50,000 or half of your current vested interest (whichever is lower).

While this may all sound ideal, there are some drawbacks. Taking out a loan from your 401(k) typically freezes the account — you can't make additional contributions during the life of your loan, and employers can't contribute, either. While you pay your loan back, you'll miss out on growth opportunities for your retirement fund.

The other drawback is that after the five-year term, unpaid funds are considered an outright withdrawal, which incurs income tax and other financial penalties.



401(K) WITHDRAWAL

SHOULD YOU WITHDRAW THE AMOUNT FOR DOWNPAYMENT?

The other (less desirable) option is to take an outright withdrawal from your 401(k) fund. The reason it's such an undesirable option is that you'll automatically pay a 10% penalty on the funds you withdraw and you'll pay income tax on top of it. That said, you don't have to pay back the funds you withdraw. In certain circumstances, people may feel that this benefit outweighs the other financial penalties incurred.

There's also no limit to the amount you can withdraw from your account. You can take out as much money as you want as long as it's equal or lower than your vested interest.

SHOULD YOU USE YOUR 401(K) TO BUY A HOUSE?

TIn general, home buyers should not use their 401(k) to help buy a home except as a last resort when:

1. A low- or no-down payment mortgage is unavailable
2. The down payment is too small to purchase a home

Even then, home buyers should investigate every available option before taking money from their 401(k) to fund the purchase of a home.
Taking money from your 401(k) is a high-cost transaction:

- A tax is assessed on early withdrawal
- A penalty fee may be charged on cash withdrawn
- The tax advantages of investing are lost or reset permanently