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Don't use a 401(k) to fund home down payment

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Many buyers often think the fastest route to home ownership is to crack open their retirement nest egg and make the mistake of using their retirement accounts and 401(k) savings to finance a home down payment.

Oftentimes, this tactic comes at a price and a big chunk of your retirement savings go to income taxes and penalties, forever giving away the tax-deferred growth on earnings and contributions. While real estate has proved to be a solid investment, spending your retirement savings to purchase a home can have negative long-term effects on your financial health.

A withdrawal from your 401(k) may seem like a great option and an untapped resource for a home down payment.

Here lies the problem: When withdrawing 401(k) funds, you will pay income taxes on the money withdrawn and face an early withdrawal penalty, usually 10 percent of the account balance if you are 59.5 years or younger.

Additionally, future tax-deferred earnings and compounding on the savings are lost. This dent to your retirement finances could be enormous based on your age at the time of withdrawal and if that money is saved until retirement.

Another option when it comes to using retirement funds for home down payments is the retirement-plan loan. Buyers with this type of loan can borrow a chunk of the savings tax-free and then repay the outstanding balance with interest over a period of time. The interest is usually low, 1 percent to 2 percent over the prime interest rate, and the

payback period is usually five to 10 years. A great deal, or so it seems, but upon further investigation the loan does have a financial cost.

In addition to upfront and ongoing administration fees, some plan administrators charge on account loans. The money you pay yourself back comes from after-tax earnings that doesn't lower your annual taxable income the way a regular 401(k) contribution does. As mentioned above when discussing the 401(k) account withdrawal, the savings that would have been growing tax-deferred is lost.

Make sure you consider the above financial consequences, and if necessary, wait to buy a home until you have saved enough for a down payment. There are many costs that come with home ownership, including maintenance, property taxes and insurance.

Buyers, especially first-time homebuyers, often don't consider the costs that come with home ownership and may be stretching themselves too thin with just the mortgage payment.

Additionally, if possible, downsize what home you would like to buy. A three-bedroom, two-bath house may be what you would like, but the cost may be out of your reach and it might be better financially to buy a condo or a "starter" home.

If after considering all the alternatives to borrowing against your 401(k) for a home down payment, make sure that you have a plan to rebuild the account. Make sure you immediately begin regular contributions, even when paying back the retirement-loan plan, and set aside

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enough of your earnings to cover any employer match your company may offer.

Set a goal to return to your pre-loan contributing level before the loan is paid and, if necessary, talk to a professional about how to maximize your retirement contributions and dollars.

Coghlan Financial Group, LLC, financial advisers who specialize in financial planning, retirement and estate planning, risk management, portfolio design, asset management services and financial goal integration, regularly holds free educational seminars for local companies and their employees on the facts and questions of retirement planning.

The questions come easily but the answers don't until further investigation and more in depth planning is done. So much depends on the indi-

vidual, his or her needs and goals, retirement money available, the company plans and retirement strategies.

In addressing these common concerns and in working with employees, Coghlan Financial Group has developed a program called the "Retirement Planning Review." This is a comprehensive review tailored to each individual that provides a future retirement income analysis and helps individuals determine whether or not they are on track to meet their goals.

Coghlan Financial Group also provides regular mailings, quarterly newsletters and personal appointments to address more specific retirement planning and investment needs.

For more information, visit www.coghlanfinancial.com or call (800) 884-5121.

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