



A Hard Look at 401(k) Loans

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At first glance, taking a loan from your 401(k) looks easy and very appealing. We agree with the easy part. You simply call your 401(k) Services Center (or go online), talk with a phone representative, and you receive a check within a few days. However, is your 401(k) account really the best place to go for a loan?

Within the SSPP, PSP, SSIP, TESPHE, and most other 401(k) plans you can borrow up to 50% of your account value capped at a maximum of \$50,000. You pay yourself back with interest over the repayment period you specify (within plan guidelines). Compared to the returns of the stock market over the past few years, this may look like your single best investment.

Even though that may be true over the past three years, we don't think it will remain so going forward. Remember, the money you borrow from your 401(k) account leaves the account until you repay it, and therefore is not at work building your retirement nest egg. After the stock market's recent fall to near its five-year low set on October 9, 2002, we believe members will do well to remain invested over the next five years.

Another problem with 401(k) loans is double taxation. The interest you pay yourself is not tax deductible and hence paid with after-tax dollars. However, when this money is eventually withdrawn from the plan, the entire amount is taxed again as ordinary income. Therefore, you get taxed twice on the same dollars.

We think a better place to look for a loan is within your own home. Home equity loans and home equity lines of credit are currently available at very attractive interest rates and the interest is generally tax-deductible. This makes the effective "after-tax" interest rate on a home equity loan as low as 3% to 4% depending on the terms of the loan and your tax bracket. We believe even a conservative 401(k) portfolio will likely outperform those rates over the next five years. Therefore, our recommendation is to take the attractive rates on a home equity loan and keep your 401(k) savings intact.