

Four Reasons Not to Borrow from Your Retirement Plan

If you're short on cash, try to avoid borrowing from your workplace retirement account unless there is no other option available. Taking out a loan, if offered, can seriously hamper your ability to build savings. Here's why:

1. Until you repay the loan, you'll have a smaller portfolio to take advantage of potential tax-protected growth, likely reducing the size of your account at retirement.
2. Generally, you must repay the loan in full, with interest, within five years. If you don't, then it is considered a distribution and you'll have to pay income tax on the outstanding balance, plus an early-withdrawal penalty if you're under age 59½.
3. The loan is also considered a distribution if you leave your job for any reason and do not repay it in full within a set time frame—typically 60–90 days.
4. There can be fees for borrowing from a retirement plan. (Many plans charge one-time origination fees.) Plus loan repayments, unlike contributions, must be made with after-tax dollars.

To avoid facing a cash crunch, make it a priority to build an emergency fund for unplanned expenses or events, such as car repairs or a job loss. Set aside a little from each paycheck with the goal of accumulating at least three to six months' worth of living expenses. This way, you'll be better able to handle those curve balls life can throw from time to time, without having to tap your retirement funds.

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