7 Questions to Ask Before Borrowing From Your 401(k)

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Make sure you understand the consequences.

To hear financial planners talk, you'd think that borrowing money from your employer-sponsored retirement account is pure madness. Don't do it! It's a bad idea!

But in one recent survey*, about 41% of respondents had taken a loan from their retirement savings. And while 7% said they regretted taking the loan, a full 53% did not. Does that mean it's sometimes okay to do this?

Here are a few questions you should ask yourself before dipping into your 401(k) piggy bank:

Do I really understand how it works? Many people hear that they can borrow money from themselves in an advantaged interest rate scenario where they're paying interest to themselves. Great, right? "What they often don't get is that it removes the money from working for you from an investment perspective, because it removes the money from the allocation where it should be," says Andrea Blackwelder, a financial planner in Denver. "At the end of the day, you have to understand that you're borrowing from your future retirement self." The longer it takes you to repay the loan, the longer that money is out of commission.

Is my job super secure? In many situations, if you take out a 401(k) loan and then lose your job, you'll be required to pay back the loan in full within a specified time frame, often 60 days. If you don't have the ability to do that, the loan will be considered an early distribution, and you'll owe taxes and penalties on it. "That's where most financial planners say there's a bit more risk than other types of financing," Blackwelder says. "If you were to lose your employment, the loan pretty much comes due."

Am I using the money to buy an appreciable asset? In other words, are you putting your investment money into another investment? "The loan is more justifiable for appreciable assets, such as a home purchase," says Mark Amberg, a financial planner in Alexandria, VA. "It is a bad transaction to pay for depreciable assets with assets from the 401(k). That shiny red sports car will seldom appreciate. The loan will be lost if used to purchase assets that decrease in value."

Am I hoping to use the money to pay college tuition? This is just a bad idea. There are a variety of other ways to borrow for school that won't directly impact your retirement funds. "When I think of 401(k) loans, I think of very specific, short-term situations where you need a little bit of a patch," Blackwelder says. "Most of your college loans are going to be on the books for decades."

Am I trying to bail out my children? "A lot of times people call in because they feel that their children are in desperate situations and absolutely need money," says Joe Krier, a financial planner in Jacksonville, FL. "A parent might be best off just turning the kid down and letting them learn something."

Is it a short-term need? "Generally, [your 401(k) is] the last place to go," says Daniel Galli, a financial planner in Norwell, MA. "Exceptions are for a short-term 'bridge' loan when the money can be repaid in a short time, such as closing on the new house before selling the old one, or paying tuition or another bill before a CD or other termed money becomes available. Paying off credit cards, loan consolidation and other uses are usually not a good idea."

Do I have other options? "With all the low money down mortgage options now, if you don't have enough for the down payment, then you shouldn't be buying a house," says Jim McGowan, a financial planner in Doylestown, PA. "The only way I would use it for a down payment is if you use the money to get better terms on a mortgage loan then, after closing, get a home equity line of credit and use those funds to pay off the 401(k) loan."

If you are seriously considering taking a loan from your 401(k), please contact our office. There have been some rule changes due to the CARES Act that would be worth discussing. Reach out to us via phone or email, at (248) 879-4510, info@glebaandassociates.com.

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*SURVEY SAYS: Taking Retirement Savings Prematurely, PLANSPONSOR, May 31, 2016.

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