Government Executive

Should You Use Your Retirement Savings to Buy a House?

By Tammy Flanagan

March 9, 2017

Last week we talked about ways to assess whether or not to leave your money in your Thrift Savings Plan account in retirement.

One specific question along these lines that comes up often at retirement seminars is "Does it make sense to withdraw a large lump sum from my TSP account after retirement to buy a house or pay off my existing mortgage and limit my tax liability?"

To answer to this question, I turned to Mark Keen, a certified financial planner at the firm Keen and Pocock in northern Virginia. Mark writes a monthly column called "Managing Money" for the National Active and Retired Employees Association's magazine.

Here's what he had to say:

The problem with taking large lump-sum distributions from tax-deferred retirement plans, such as the money in the traditional TSP balance, is the withdrawal is taxable income, and depending on the size of the withdrawal, it may be taxed at least one higher bracket than it would if the money were distributed over a series of payments.

For example, let's assume a couple has taxable income of $50,000 and decides to withdraw $200,000 from their TSP. The first $25,900 will be taxed at 15 percent, $77,200 will be taxed at 25 percent, $80,250 will be taxed at 28 percent, and $16,650 will be taxed at 33 percent.

What I call stealth taxes should be considered as well. For example, for those over age 65, the extra income may trigger higher Medicare Part B premiums, and at higher income levels, you lose personal exemptions and itemized deductions are phased out.

Unfortunately, the TSP has limited withdrawal provisions. You're only permitted a once per lifetime partial withdrawal. After that, you must elect one of the full withdrawal options, which include a full lump sum withdrawal, monthly payments (based on a specified dollar amount or on life expectancy), and an annuity.

You may be able to use a combination of a partial withdrawal and monthly payments based on a specified dollar amount to take distributions over several years in order to keep the income in lower tax brackets. Alternatively, you may find it in your best interest to take a partial withdrawal for the full amount you'll need and transfer it to an Individual Retirement Account. Once in the IRA, you can take withdrawals in any way that works best for your circumstances.

If you're planning on buying a house soon after retirement, you may not have the time to spread withdrawals out over several years. If you're over age 59 1/2, you may be eligible for an in-service withdrawal, which can be transferred to an IRA. This might be a good strategy for you if you plan on working for several more years, because you'll have time to spread out the withdrawals from the IRA over the years before your retire.

I also have recommended taking a loan out and using TSP withdrawals to pay back the loan. This accomplishes the goal of spreading the distributions out over multiple years while addressing the situation where the money is needed in the near term and spreading withdrawals out over years isn't possible.

When possible, I like to convert the distributions from a tax-deferred retirement plan to a Roth IRA rather than letting the money accumulate in a taxable account. The Roth money may then be used for the purchase, but any leftover gets to remain in the Roth and grow tax free.

Another reader, "George," noted that the early days of retirement may not be the best time to purchase a house:

Looking back, I would not have put myself in the process of buying a home during the overlap period between my last day on the job and my first full retirement check. Before or after works, but not in the breach. Deferring a major financial decision for six months or more would have been prudent, and I'd recommend that to anyone. Finalizing the home purchase before retirement would be better, or waiting until after your annuity is being paid in full. I was in the process of buying a new home when I retired. I soon learned that at the critical period when an underwriter was going to be looking at my income for a mortgage, there was nobody to answer. My payroll office said, "He's gone," and OPM would say, "Never heard of him." I was able to get a letter that documented my prospective annuity from the director of my civilian benefits office. Without it, I would have had a problem.

George also had this to say about determining exactly what your income will be in retirement:

Remember that the rules of retirement are extraordinarily complex, and the sources of information are scattered, confusing and often misaligned. I took a retirement planning class within six months prior to retirement, and there were many topics that weren't covered in class. I retired last fall with 40 years of creditable service, including sick leave, in the Civil Service Retirement System. I had accumulated 321 hours of annual leave and credit hours, which were paid *out on my last paycheck, minus a substantial taxation. Also, I was fortunate in receiving a Voluntary Separation Incentive Payment offer, which is being paid out over 12 months. After retiring at the beginning of September, my first partial annuity arrived on Oct. 3, at a rate of approximately 65 percent of the full annuity. The next payment in November was at 78 percent, along with a make-up payment in mid-November. I received my first full annuity payment on Dec. 1. OPM's calculation of the annuity tracked well to both my own estimate and to the last estimate I received before I retired from my employer.*

So, as the old saying goes, look before you leap. Or as the great Smoky Robinson and the Miracles said in 1960, "You better shop around."

Photo: AAG.com

By Tammy Flanagan

March 9, 2017

http://www.govexec.com/pay-benefits/retirement-planning/2017/03/should-you-use-your-retirement-savings-buy-house/136037/