NITP
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In-The-Know Monthly eNewsletter

Think Twice Before You Take a TSP Loan
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My car breaks down. I need to replace the A/C unit in my home. I am left with one final college term to pay for my daughter. The list goes on and on! These are a few of the potentially unanticipated emergencies that could happen to anyone. You may someday need a large sum of money in a hurry. As you look around for a source of funds, your eyes might come to rest on your TSP. It's yours - - why not tap into it?

Let's explore how you might access the money in your plan. You can borrow up to $50,000 from your TSP account, or one-half of your vested plan benefits, whichever is less. You've got up to five years to repay your loan, although the repayment period is up to 15 years if you use the funds to purchase a primary residence.

I see a few advantages regarding TSP loans. I appreciate the fact that you have some time to repay the loan. Best of all, you pay yourself back with interest. The interest rate will be the G Fund rate at the time of your loan application and will be fixed for the life of the loan. This is certainly a lower interest rate than what you might be charged from a consumer credit card! The TSP will charge a $50.00 fee to process each loan. Additionally, the repayments are simply deducted from your paycheck. Sounds pretty good, right? There may also be a few other considerations to think about before taking a TSP loan.

You will likely reduce your retirement savings. The TSP is designed to help you build funds for one purpose: retirement. To encourage you to take advantage of your TSP, the government defers taxes on your earnings and allows you to make contributions with pre-tax dollars. However, when you take out a loan from your TSP, you are removing resources earmarked for your retirement. Even though you'll repay the loan, you can never get that time back when your money could have potentially grown - also referred to as opportunity cost.

Let's also think about the tax consequences. A TSP residential loan is not a mortgage; interest payments are not tax deductible as they might be for a mortgage or home equity loan. You should quickly repay the loan within 90 days if you separate service from the federal government. If you don't repay it by then, the outstanding balance will be taxable -- and if you're under 59.5 years of age, you'll also have to pay a 10 percent early withdrawal penalty.

As I consider the pros and cons of taking a TSP loan, I am reminded of the importance of building an emergency fund containing three to six months of living expenses. Keep the money in a liquid, interest-bearing savings account so that you can tap into it quickly.

Although you can't predict the future, it is important to clearly understand all of the options that are available. I am certain that this will help to ensure you are that much more comfortable and confident during such a challenging time.

Mr. Dean has served as a financial advisor for 10 years and speaks regularly to both pre-retiree and mid-career level groups as part of NITP. His areas of specialization are investment consultation, retirement planning, and advanced planning strategies.