Tom Mullooly: We want to respond to a letter that we saw that said, "Help, I think I've wrecked my family's finances." Stick around.

Welcome to the Mullooly Asset Show. I'm your host today, Tom Mullooly. A great article on MarketWatch, we'll link to it below, where someone wrote in asking for help saying, "I think I've wrecked my family's finances. I went to buy my first home and I think I've made a huge mistake." So the first couple of points is that the writer said, "Hey, I was worried this year because I saw mortgage rates. I was worried in 2022 because I saw mortgage rates moving up very fast." So two, "What I did was I withdrew all of my money from my 401(k) at work, and I stuck it all in the bank about $26,000. Didn't withhold taxes, didn't really prepare for this."

And so three, now, the person who wrote this is worried because as they wrote, "I might have to pay taxes and penalties on the distribution." Yes, you will. And they wrote, "I can't afford to pay the taxes because I put it all in the house." We've actually heard these kind of scenarios before. So, the first point to make is you could have taken a loan from the balance in the 401(k) and you could pay it back.

Now, some things that a lot of folks may not understand. You can take a loan from your 401(k) really for any kind of reason. If it's not specific, you have to pay the money back in five years, that's 60 equal payments. However, if you're buying a first time residence, you can pay it back usually over a longer schedule. And in some cases, that can be 15 years. And you're paying yourself back. So yeah, you're not going to have that money invested into the stock market or in different investments, but you are paying yourself back with these kind of dollars.

So, I also think it's important to know what the tax is and the penalties, what the ramifications are before you do something like this. That's a huge, huge step. So, I also want to throw in the fact that the IRS does permit people to take $10,000 penalty-free from an IRA for the purchase of their first time home buyer purchase. Now, that exclusion is not specifically written for 401(k) plans. And I do want to add that it's penalty-free when you take money from your IRA, but it's not tax free.

So, with a 401(k), what can you do? Well, there is such a thing as a hardship provision. And it seems like every plan is a little different when it comes to these hardship provisions. In many cases, you have to fill out some paperwork, you probably have to write a letter describing why you're in a hardship. And it's got to be a hardship like, "I'm getting evicted from my apartment," or something. It has to be a hardship. And that usually goes to some kind of committee. So understand, there's paperwork, there's a process, it does take time. So it's not something that's going to happen by Friday.

So, if you're planning, I think this really is the big takeaway, if you're planning to buy your first home, putting money into a retirement plan at work, whether it's your deferred comp plan or 401(k) at work, that's not the place to do that. Don't do that, okay? So, you need to put this money in the bank so you can access it. Putting money into these retirement plans comes with a lot of strings.

I also gathered from the gist of the letter that was written that this person didn't have any kind of emergency fund. And any kind of financial planner would spot that right away. That's a huge red flag. You have to have an emergency fund before you start putting money away for first time home purchase, before you're putting money into a retirement plan. So, this is why you work with a financial planner, these kind of things. This could be a very, very costly mistake for this person. Don't let that happen to you. That's the message for today's episode. Thanks again for tuning in. Don't forget to click that Subscribe button if you haven't already.