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There Are No Retirement Loans

By Stephan Roche, Electronically reprinted from March 27, 2007

Americans lead the world in buying on credit and financing our purchases. But, while it's easy to finance a home or a car or even an education, you can't take out a retirement loan. There is no "retirement equity line of credit" or zero-interest retirement credit card. Try as you might, you simply can't finance your retirement.

This may sound like a no-brainer. Lenders rarely loan money to someone without a job, and isn't the point of retirement not to have a job? Still, a surprisingly high percentage of Americans put other near-term goals ahead of saving for retirement.

For instance, 529 plans have skyrocketed in popularity as a way to save for college. I applaud any parent with such foresight and generosity. But is a college fund the best place to allocate your savings dollars? The surprising answer: not always.

It turns out that there are alternatives for funding a college education: scholarships, grants and low interest loans. There are no similar alternatives for funding retirement. Besides, if you sacrifice your retirement account to fund your kids' education, your kids may end up being your only option for paying the bills in retirement. Is that a risk you want to take?

Another common savings strategy for Americans is to pay down your mortgage. Making additional principal payments helps to reduce the interest you

pay on the mortgage and accelerates your payoff. Again, I congratulate anyone with this kind of savings discipline, but if making those extra principal payments means you don't have that extra $250 or $500 each month to contribute to your 401(k), consider what you're missing:

Free Money: Your employer may offer a company match on your 401(k) contributions. You should at least be contributing enough each month to maximize this "found money."

Tax Benefits: A diversified 401(k) investment portfolio can potentially earn more than the tax-deductible interest cost of your mortgage. In other words, contribute to your tax-deferred 401(k) first.

Saving for retirement should never feel overwhelming or complicated. You can keep retirement saving simple and still achieve your goals.

The beauty of savings is that making small sacrifices today can produce large rewards down the road. If you get an early start, time is certainly on your side.

Imagine there are two investors, each with their own retirement plan. Both investors earn the exact same salary and share identical investment goals. They both earn an 8% return on their investment every year after expenses.

Jennifer begins setting aside $3,000 a year in her company 401(k) at age 27. She contributes for 10 years and then stops. Her total contribution is $30,000. At age 65, Jennifer will have over $425,000 in her retirement account.

Jason waits until he's 37 to start investing $3,000 a year in his 401(k). But he contributes every year right up until age 65 for a total contribution of $84,000. Though Jason saved nearly three times as much as Jennifer, his retirement account will total $312,000.

Jennifer contributes less than Jason but accumulates over $110,000 more all by taking advantage of compounding. It pays impressive dividends to start early. In fact, if Jennifer had started at age 26, just a year earlier, she could have $35,000 more in her account without having to contribute one single penny more in savings.

Saving for retirement is a whole lot easier than everyone thinks. The hardest part is getting started. One thing I can nearly guarantee is that the earlier you start, the better off you will be. Make a few easy decisions now and start today. You'll spare yourself much harder decisions down the road.

While Americans have grown all too accustomed to "buy now, pay later," that's simply not an option when it comes to retirement—at least not yet.

Stephan Roche is vice president of ShareBuilder Corporation. For more information about ShareBuilder, visit www.sharebuilder401k.com.

Note to readers: *The performance example provided in this article is hypothetical and not a guarantee of future returns. It compares how savings and returns placed in the same investment with different time horizons can grow over time and will differ over time. It assumes an 8.0% fixed annual rate of return. Your account may earn more or less. Actual experience will vary with portfolio selections and changing market conditions. The total account balance does not take into account federal and state income taxes, which will be due upon withdrawal. Assets withdrawn before 59 1/2 from a 401(k) or IRA account may incur a 10% penalty.*