

The following is an excerpt from the
"12 Questions to Start Late & Finish Rich" teleseminar
interview with David Bach, hosted by Alex Mandossian.
For more info, visit: <http://www.finishrich.com/teleseminar>.

Alex: Here's the next question, David. It's on student loans:

"As a 39-year old who went back to school (changed careers) several years ago, I now have \$50,000 in student loans at a good interest rate and another \$39,000 in loans due to school debt/expenses; and \$10,000 in a 401K."

Now here's the deal. "As a renter," so, this person's renting, "does it make sense to take money out of the 401K to pay off the student loans and free up \$500 per month, or does it make sense to do something else?"

David, what would you do?

David: First of all, let's talk about student loans for a second. So many people may have student loans, and I know we got a lot of questions on this. There's a lot of student loan debt out there. It's very common now to talk to people who have \$50,000 to \$100,000 in student loans. They feel really bad about it. Don't feel bad about student loans.

Here's why.

In most cases, today's rates on student loans are below 5%. I call this good debt. It's good debt because you borrowed money to get yourself an education, to make yourself smarter. One of the most important investments you'll ever make is in yourself. You have the knowledge for the rest of your life. That education is going to help you feel you have a better job, a better career, a better future, so you made a great investment.

This is not like going crazy and going shopping and buying clothes. This is a good investment. Number two, the rates should be low. If the rate's not low, you should be looking at refinancing your student loans and locking in these low rates. First of all, if it's a low rate, don't worry about it. Second of all, let's talk about the 401K plan right now.

If you've got a 401K plan, the worst thing you could do when you're 39 years old is take money out because if you do, two things are



going to happen. One, the government is going to penalize you. They're going to give you a 10% penalty on your withdrawal.

Let's take the \$10,000 example. This person's going to get hit with a \$1,000 penalty, but they're also going to get hit with taxes. The \$10,000 is going to show up on their income as ordinary income, the government's going to want their take, which is about 40%. Now, this person's going to pay \$4,000 in taxes and \$1,000 in penalties. They've got \$5,000, minus \$10,000, they're only going to have \$5,000 left after they take the withdrawal. It's a very bad approach to take. You want to leave your money in your 401K. The only reason to take money out of your 401K plan, in my opinion, is to try to buy a home. In many cases, the best way to do it is to borrow the money out, and I'll talk about that later. Here's what I say.

If you've got student loans, don't worry about paying them off early, provided the rate is low, just keep making your monthly payments. Make those payments on time, however, because if you don't, it can really screw up your credit record.

Then, focus on paying yourself first, which means using your 401K plan, and in this person's case, they've got the big magic word — renter. We don't want to see a 39-year old renting. Renting is a bad thing at 39. We want to get you focusing on buying a home, and we'll talk about that in a little bit.

Alex: Many times the payments are the same, and you're deducting, so it's a very interesting situation. I had no idea that the taxes are paid when we're taking money out of the 401K early. I mean, how ignorant am I? I can't believe the amount of penalization, aside from just the 10% penalty, with the taxes. I mean, it's a no-brainer, right?

David: It is a no-brainer. What's scary right now is we're seeing about one in two people under the age of 45 cashing out their 401K plan. In many cases, they're spending the money, not realizing they're going to have to pay taxes and penalties on it. Then, they're getting hit with the bill at the end of the year, and they can't even make the payments.

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