



The Cost of TSP Loans

When you borrow from your TSP account, loan payments (including interest) are deducted from your pay and deposited to your TSP account. Although you are restoring funds to your TSP account during the life of the loan, those funds and their earnings may not equal what you would have had if you had not borrowed from your account. Borrowing from your TSP account will affect the final account balance available for your retirement. The following examples illustrate the effects of borrowing.

The Cost of Residential TSP Loans. Let's assume that you need to borrow \$10,000 to purchase a home, and that a mortgage loan is available from your bank at 7% for 15 years. The monthly loan payments (principal and interest) would be approximately \$90, and, over the life of the loan, you would pay about \$6,200 in total interest. But mortgage interest is a tax-deductible expense on your Federal income tax return, and so, if you are in the 28% Federal tax bracket, the effective interest cost of your loan would be reduced to about \$4,500.

The \$10,000 that remains in your TSP account — because you borrowed from the bank — would continue earning for the next 15 years. Let's assume that \$6,000 of your account is invested in the G Fund and \$4,000 in the C Fund. Using hypothetical compound annual rates of return of 8% and 15% for the G Fund and C Fund,* respectively, your TSP account would earn approximately \$41,600 over 15 years. Therefore, your "net earnings" at the end of 15 years would be \$37,100 (\$41,600 – \$4,500) if you borrow from the bank.

Now, let's suppose you borrow the \$10,000 from your TSP account instead of the bank. If you do, you will not have to pay the \$90 per month to the bank, but you will also lose much of the \$41,600 in earnings you otherwise would have received on your TSP account. Also, the "interest" you pay yourself for a TSP loan is not tax deductible.

To illustrate: If the TSP loan rate is 6%, you will have to repay approximately \$84 per month to your account for 15 years. (As in the above example, assume that your contribution allocation is 60% to the G Fund and 40% to the C Fund over the 15-year repayment period, so that your repayments go into the two funds in those proportions.) At the end of 15 years, you will have restored your TSP account balance to \$10,000, but — using the same G and C Fund annual rates of return as above — you will have earnings of only about \$27,500.

To offset the diminished TSP earnings somewhat, the \$6 savings between the monthly bank loan payment and the monthly TSP payment (\$90 – \$84), if invested at, say, 5% over 15 years, would be worth approximately \$1,500 to you — about \$1,100 in savings and about \$400 in interest (after Federal taxes of 28%). Therefore, your "net earnings" at the end of 15 years would be \$29,000 (\$27,500 + \$1,500) if you borrow from your TSP account.

The difference between your earnings when you borrow from the bank and your earnings when you borrow from your TSP account is \$8,100 (\$37,100 – \$29,000), which is the cost of borrowing from your TSP account.

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* These rates of return and all others assumed in this discussion are not intended to be projections of future rates; they are used for illustration only.

The Cost of Other TSP Loans. If you need to borrow money for some other purpose, it may be less expensive to borrow from your TSP account than to borrow from commercial sources.

For example, assume your best alternative to borrowing from your TSP account is a 4-year personal bank loan of \$10,000 with a 15% interest rate, which would require monthly payments of approximately \$278. You would pay approximately \$3,300 in interest over 4 years on this loan, which is not tax deductible. Your TSP earnings on the \$10,000 that remain in your account (\$6,000 invested in the G Fund and \$4,000 in the C Fund over the term of the loan at the hypothetical compound annual returns of 8% and 15%, respectively) would be about \$5,200 over the 4 years, for “net earnings” of \$1,900 ($\$5,200 - \$3,300$).

However, if you borrow \$10,000 at 6% from your TSP account to be paid back over 4 years, your monthly payments will be about \$235. In 4 years, your account will be restored to \$10,000, and you will have earnings of approximately \$3,900.

In addition, if you invest the \$43 difference between the monthly bank loan payment and the monthly TSP payment ($\$278 - \235) at 5% over 4 years, you would have approximately \$2,200 in savings and interest (after Federal tax of 28%). Your “net earnings” after 4 years would therefore be about \$6,100 ($\$3,900 + \$2,200$).

The difference between your earnings when you borrow from your TSP account and your earnings when you borrow from a bank is \$4,200 ($\$6,100 - \$1,900$). Thus, upon the assumptions given, it would be less expensive to borrow from your TSP account than from the bank.

Summary. Although the principal and interest you pay back to your TSP account during the life of your loan will restore funds to your TSP account, there are costs of borrowing from yourself as illustrated above. Be sure you understand the financial effects of borrowing before proceeding with your TSP loan.