Loans from Solo 401(k) plans holding steady

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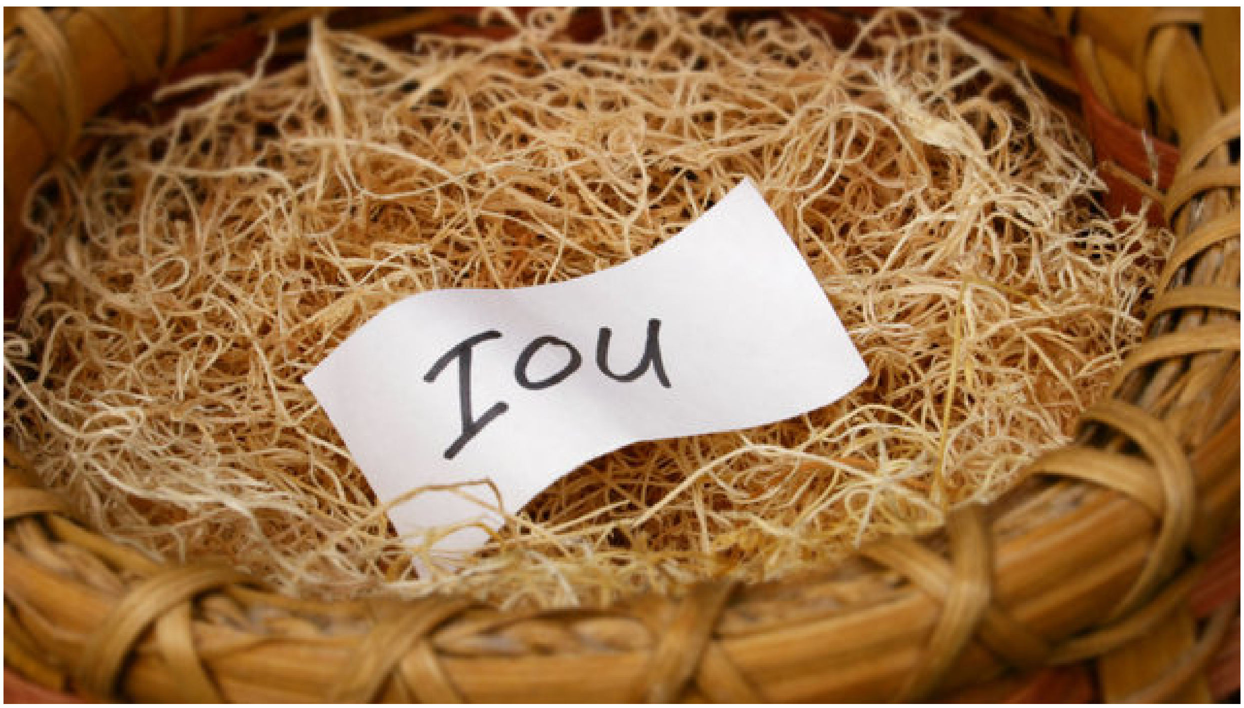

Photo: Getty Images

Even as the economy improves, the pace of loans taken from Solo 401(k) plans is holding steady.

“That’s somewhat surprising to us,” said Adam Bergman, a partner with the IRA Financial Group, a New York-based provider to about 3,500 Solo 401(k) plans.

Solo 401(k) plans are available to independent contractors or small business owners, and their spouses, that don’t have fulltime employees.

The contribution limits are the same as with **standard 401(k) plans**. In the Solo plan, the employer contribution can not exceed 25 percent of income, and the ultimate annual contribution limits are capped at $53,000 for 2015, not including catch up contributions.

Bergman said between 20 and 25 percent of participants in the firm's plans access their loan feature, which, prior to 2001, was not available to Solo 401(k) plans.

"When the economy was still recovering in 2010 and 2011, we expected higher loan rates," he said. "People were losing work and using the loans to live on. So we expected the rate to come down at bit as things improved, but our internal data from the first quarter shows it's remaining steady."

Loans from Solo 401(k) plans are structured similarly to those from standard 401(k) plans, which can be made for up to $50,000, tax and penalty free so long as they are paid back with interest over five years.

These days, Bergman said IRA Financial Group's clients are reporting using the loans to pay off credit card debt.

"It's a great feature for those independent contractors or business owners that know they can pay back the loan on time. You replace credit card debit, which can carry up to 18 or 19 percent interest, with debt to your plan, a much lower interest rate."

Different interest rates can be established when paying back a loan to a Solo 401(k). The lowest is the prime interest rate, currently at 3.25 percent.

A $50,000 loan at that rate would mean monthly payments of $904 a month over five years, according to Bergman's math.

With interest, that would mean $54,000 returned to the plan, not including the dollar-cost averaged returns of repayments made throughout the loan period. That means the plan isn't necessary hemorrhaging retirement assets throughout the loan period, said Bergman.

The average account size of IRA Financial's Solo 401(k) plans is about $160,000, for all demographics.

Nationally, there's no good clearinghouse for Solo 401(k) data and adoption rates. The reason? Form 5500s are not required of plans with less than $250,000 in assets.

But from his own perspective, Bergman is sensing a definite uptick in interest.

“We're seeing more demand them. We're not sure if that is because more people are becoming acquainted with them and their advantages, or because more people are working as independent contractors. But the demand is certainly growing.”

The loan feature, which of course is not available to IRA owners, is more commonly being sited as the reason behind the interest, Bergman added.

“We even see a lot of W-2 employees that do contracting work on the side inquire about the option because their regular employer's plan doesn't have a loan option.”