EPISODE 1178

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FT: Welcome back to So Money, everybody. I'm your host, Farnoosh Torabi. Thank you for joining me on this Friday, March 26. Our Friday shows our chance for you to connect with me personally, send me your money questions. If you are new to the show, it's very simple to get in touch. Many ways you can get in touch; you can direct message me on Instagram @farnooshtorabi your question. You can also email me farnoosh@somoneypodcast.com. And if you go on to the website, somoneypodcast.com, you can click on Ask Farnoosh, leave me a voicemail or type in your question.

This week, we have questions regarding 401(k)s, using a Roth IRA to purchase a home and a listener wondering whether to put down 10% or 20% on a home down payment, the potential risks. Before we get to the mailbag, I just want to do some housekeeping and also, a follow up on something that I announced last week. Which is that I have a change happening coming soon to my business, and it's exciting. I can't wait to share it with you. It's going to probably be announced in the next month. It was so funny because I asked on the show last Friday if you have any guesses as to what this may be, and you weighed in. I have to say, I was really impressed with some of these ideas, really shows how much you think of me and how much you're rooting for me.

One person guessed, "I know. You're going to get your own segment on the NBC Today Show." Well, that is not the answer. Well, that is not actually what I was going to — well, I'm going to say, that's a great guess and I hope that comes true one day. It's not exactly what I'll be announcing in about a month, but it very well could be something in my future. It would be nice for the today show to just make it official. I've been going on quite regularly for 10 years, more than 10 years. It's like we've just been dating for all these years, like just make it official NBC. But you know, your lips to God's ears.

Somebody else said, “Book deal.” Yeah, that is something that I hope will happen this year. I’m working on a book proposal right now. It’s taking a lot of my time and energy. It’s really hard to put together a book proposal, I forgot. The last time I did one was six, seven years ago. But I’m really excited for the potential of this book, probably won’t read it for another few years with the pace of books getting released and all that, but that was a nice thing to hear from a listener that maybe you would be interested in another book from me. So keep the guesses coming. It’s been really fun to hear from you what you hope for me. I promise that in about a month, you will get official word and you’ll be among the first to know.

Let’s head over to the iTunes reviews section and pick our reviewer of the week. This person gets a 15-minute phone call with me for free, where we can talk about whatever you want, whatever questions you may have. This week our lucky winner is Megan, who left a review this week saying, “Love this podcast. Farnoosh does such a good job covering a variety of topics. She brings on guests that offer awesome advice. I would recommend this show to anyone looking to be more inspired.” Megan, thanks so much for your kind words. Get in touch and I will send you a link where we can connect. You choose a time for us to connect for 15 minutes. You can email me, farnoosh@somoneypodcast.com. Hit me up on Instagram, direct message me there and just let me know you’re the Megan who left the review and I will promptly reply.

I actually just got off the phone with Janet, a reviewer from last week and we had a blast. We actually talked for about 25, 30 minutes about all the things. We talked about our jobs, and taxes, and crypto and the stock market. She’s out there in Burbank enjoying the sun and the warm weather, so she was giving me extreme, extreme FOMO. I really enjoy these conversations with listeners, so don’t be shy. Leave a review with the hope that we will connect and maybe we will.

All right. Let’s review our week a little bit. Let’s go to the So Money podcast website right now and just highlight some of the incredible interviews and guests that we had. On Monday, we had Abby Falik, who’s the founder of Global Citizen Year. The pandemic drove many incoming freshmen college students to defer that first year of college and take what we often call a gap year. Abby and I really discussed about how this should become the norm. Abby is a social entrepreneur, as I said, founder of Global Citizen Year, which is an organization that supports students in between high school and college, helping them to approach higher ed with more intention and more purpose.

Abby's goal is to take what was once considered a taboo of taking this so-called gap year to becoming something that is more widely embraced. From her end, she's seeing a lot of colleges really love applicants who talk about having taken a gap year, and there's no problem with students for the most part getting accepted to a college and then requesting a deferment, so not starting until the next year and taking that year in between to do something. Maybe some soul-searching, working to raise money. Global Citizen Year is a more formalized program, but there are so many other ways to optimize that in-between year. So often, we just sort of jump into college, a very expensive endeavor. So it does help to take a little time if that's what is important to you.

On Wednesday, we welcomed Rachel Wyman. Rachel is the owner of the Montclair Bread Company here in Montclair, New Jersey where I just moved about a year ago. This interview was really about how Rachel and her team, her small but mighty team navigated the last 12 months of COVID-19, and went from a full staff to having to furlough many, many employees. She lost a lot of revenue, lost a lot of revenue streams. How she navigated this and taking you behind the scenes. I think it's really important, even though we see a lot of mom-and-pops standing still, and we think, "Wow! How they do it?" Well, how do they do it? It's probably not an easy story to tell and she definitely went there with me and shared some of the despair, but also the hope that she for the businesses, and the community and the lessons learned.

Wednesday was also Equal Pay Day. Always a sobering reminder of the fact that women and women of color in particular make just a fraction of what men earn. Good Morning America actually reached out to me to offer some thoughts for a piece they were working on with regards to what men can do to help close the pay gap. I really appreciated that perspective, because I think that's really where we are right now in this movement, is that the women have spoken. We have shared all the ideas, and all the stories, and all of the grapes and yet we, are still in a position earning substantially less than our male counterparts at work on average. To say now that, “Hey, man. What are you going to do about?” is a really important pivot in this movement.

I think that for this to really gain more steam and for us to see real change, we need everybody to recognize their involvement. Silence is complicity. If you are a man at a company and you are seeing your female colleagues wronged, or sense even that they are being wronged, it’s important to advocate for them even when they’re not in the room, especially when they’re not in the room. We live in a society that is still run and organized by men at large, and so we need everybody, men and women to work together on this. And I think it could benefit from a little bit of rebranding. Instead of calling this a part of sort of the feminist movement or feminist goal, why don’t we say that this is a global crisis. The fact that a woman can actually earn less than a man for no good reason other than her gender is a crime, and it is not just a crime that impacts women, it impacts children, it impacts men, it impacts everybody. I always say that when women make more, the world becomes a better place. That’s not just hyperbole. That is a Fact with a capital F, and there’s so many statistics to point to that conclusion.

Whether you’re looking at statistic for example that says, women-founded startups generate twice as much for every dollar invested as those founded by men. That’s something. And yet, women receive a minuscule amount of venture capital. Give us the money, we’re good for it. Women also give more to charity as a percentage of their incomes across all income levels, and that is despite earning less than men. That is according to the Women’s Philanthropy Institute. Then we also know from many studies that women’s investment portfolios have been proven to outperform men’s. That’s just three giant statistics. If you need any reason to believe why it’s important to have equal pay, it’s because this not only benefits women, companies benefit, investment portfolios benefit, startups benefit, charities benefit. It’s annoying that I have to bring all this up, but I think that’s where were at now.

We need to just show all of the benefits, so someone could go, “Oh! That’s a good thing.” You got to pull out all the stops apparently. I hope that we will get there, but I’m done answering questions about what women can do. We’re doing everything we can we can possibly do. This year also, this whole Equal Pay Day, it was not only just a reminder about the inequity and pay, but also how given all of the last 12 months and how many more women lost their jobs is a reminder that we have to work extra hard now, to not just get the equal pay, but get the paycheck. Just having a system, women who are mothers or caregivers can work and care give at the same time, and not jeopardize their ability to earn money. That is still a work in progress and this last year was a reminder of that.

All right. That's all I'm going to say about that for today.

[ASK FARNOOSH]

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FT: Let's head over to the mailbag and answer your money questions. Our first listener would prefer to stay anonymous and she's got a question about her 401(k), a little bit of an issue there. She says that, "For the past two years, Farnoosh, I've had money retuned to me from my 401(k), because the IRS reviewed my company's plan and deemed it in equitable. This year, more than half what I thought was going to go into my plan was returned and was about $16,000 between the two years. After asking around, I think I understand why this is happening, but my question now is this, what is my next move? I had been trying to max out my contribution to no avail. My husband has a pension, but also has a deferred contribution plan, which we don't participate in. We both have IRAs, but we don't contribute to them. Moving forward, I'm thinking I should only put enough into my 401(k) to get the company match and then turn to my husband's plan. If we max that out, I suppose I would then add more to my 401(k) and hope that my money doesn't get returned, but would love to hear your advice."

Well, listeners, I followed up with this listener and I asked for a little bit more information about her 401(k). Because I never really heard of this concerning, so it turns out she got a letter that says, "The IRS requires plans to be tested annually to ensure that all participants benefit on a nondiscriminatory basis." That a portion of her contributions had to be returned in order for her employer's plan to pass the test. She said she asked around and an acquaintance told her that there's an antiquated federal law that governs this, and it was put in place to discourage companies from building plans that only benefit executives. This is according to her acquaintance.

It sounds like the 401(k) is problematic and it's unfortunate that you contribute to this and only find out after the fact, after you've contributed, after the deadlines expired for that year that the contributions could not count. That's really frustrating and honestly, until you have confirmation from your employer that they have passed this supposed test, I wouldn't feel good about contributing to this 401(k), even they returned $16,000 to you over the last two years, that's a lot of money. How do you know how much is an okay mount to contribute? It's going to be a guess. Do you roll the dice? I don't think so. I think you should contribute to something that is a guarantee. In other words, you can contribute to it and your money is not going to get returned.

I mean, look at the last two years. How much has been able to stay in the 401(k). Maybe do that again, and then max out the IRA. I would not put as much as you can into this 401(k) to earn the match, because you might get some of that returned. The IRA is a sure bet. $6,000 goes in and will stay there, and then look at how much you have contributed in the past in this 401(k)s that you would feel confident doing again, knowing that that's the amount that would stay. Talk to your employer as well. What is going on? Because if they are offering this to you as a benefit, and then it turns out it's not really a benefit, that's problematic. It's very problematic. A lot of people take jobs because of corporate benefits.

That's another topic maybe for an attorney, but it sounds like that your company needs to feel the urgency of this. Are there other employees that are getting their money returned, can you all group together and address this as a group to your company? Because otherwise, they may nto do anything about it, and that's to your detriment. Because the 401(k) is a great plan if it actually works. If they're selling you on this job to say, "Hey! We've got this 401(k) match, but actually it doesn't work. You're going to get your contribution refunded. I hope that you're talking to HR about this. Thank you for your question.

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All right. Next is Laura. Question she says,

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L: “We’re building a house that will be done in June. We’ve already put down 5% of the down payment. And with the proceeds from the sale of our current home, we want to achieve a 20% down payment to avoid the PMI, at least that’s what we’re thinking. Our lender estimates that the PMI would be about $80 a month without an additional 15% down. I have $28,000 in student loans at 4.519% interest rate, and I’m paying $100 a month in interest towards this debt. Would it be wise to use some of the proceeds from our home sale to pay off my school loans instead of getting to that 20% down payment on the new home build? We could get to 10% down, and then leave a nice savings cushion, and then the mortgage would be our only debt.”

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FT: Laura also asked the question I guess two years ago, she says,

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L: Since then, I’m now making almost triple what I was making and I’m at a company that I love. Thank you for empowering women to make that money.”

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FT: All right, Laura. I love this so much. I love this kind of question, y’all. Because it doesn’t appear to be very straightforward. You can’t Google this answer. There are pros and cons to each of these options that she lays out. So my great job is to help her identify what these pros and cons are, give her some things to think about, and maybe try to offer a bottom line. First, let's identify the two options so that we can understand what were faced with.

Option A is, Laura eventually pays down a full 20% on the new home that she's building and she takes this money from her current home sale proceeds. The pros to this are that she'll have more equity in this new home, which we know is a good thing. Ultimately, it can protect you in a market downturn where the value of the home depreciates, to where the mortgage is now more than the value of the home. In that case, you're technically underwater, and it's problematic if you need to sell in that environment, you'll be taking a financial hit. Also, good to have equity in your home if you ever want to take out a home equity line of credit, because many lenders will want to see that you have at least 20% equity before they extend you a loan.

As she points out with 20% down, she wouldn't have to pay PMI insurance, private mortgage insurance, which is the type of insurance that a borrower might be required to buy as a condition on a conventional mortgage, where you can afford a down payment of 20%, and it protects the lender's investment in the home. Those are all the pros to paying the full 20%. The downside of course is that, she won't have any money left to fully pay off her student loans or pay them down more aggressively. They do have an interest rate of 4.5%, so it is a little bit more expensive than the mortgage as far as the interest rate.

Her other option here is to put only 10% down on the house, and with the proceeds of her home sale, payoff the student loans, and it seems like she may even have a little bit of a savings cushion. The pros are that the student loans will be out of the picture, she's going to save money on interest, she's going to be able to bank some extra cash, which we know as homeowners, very helpful. Always helpful to have a savings cushion for repairs, and updates and who knows what could happen in a new home. It's a new home, brand-new, so I don't anticipate a lot of breakdowns or damages and you probably have some sort of insurance. There's usually with brand-new build some sort of like appliance insurance you'll get or a warranty for the first year if anything breaks. Make sure you get that.

The cons of course, not as much equity in her home. As a I stated earlier, there's risks to that. If the home depreciates more than 10%, that could be an issue if she ever needs to sell her home in that market. Then she of course has to still pay $80 in PMI.

The thing to really determine for yourself, to so much of a risk do I think there is even in my home depreciating, enough where I might become underwater. If you only have 10% equity and the house falls by 12% or 15% value and then, "Oh! I got to sell." What kind of a pickle would you be in? It's a very specific circumstance. It's not like super-duper probable, but I don't know your risk tolerance. Also, how long do you plan to live in the home. Is this just a starter house and you want to move in three to five years? Because in that case, you don't have a lot time for a market to correct. That could be riskier than say, planning to live in a home for 10 years, 15 years. And all the while, you're knocking down the mortgage, you are adding to the equity and you have more time to manage risks in the market.

Is your concern for a down market greater than your concern for having these outstanding student loans to manage? My opinion, option B, which is to get to 10% equity, but then use the rest of the proceeds of your home sale to do even more things, adding to your home equity, plus paying down your student loan and having some savings in the bank. That's three things that you're going to knock out. Versus the other track, which is if you put 20% down, you're going to be able to have a little bit more equity in the home, which is security and that's not to discount security. Then you're not going to be able to erase your student loans. You're not going to be able to have as much of a savings cushion.

You're still going to have some equity, 10% is still good. It's not great, but it's good. So if you do go with option B, I would pretend that the student loans still exist, and put what you were putting towards the student loans, towards the principal now of your mortgage. Try to get a little bit more ahead with building equity in your home. Maybe that's one, to two, to three extra principal payments a year. Whatever you were paying towards student loan principal, maybe you convert that into mortgage principal for a while, until you get maybe closer to 15% equity or even to 20% equity. Not a bad goal to have, to be able to get to a point where you have more equity for security, you don't have to pay PMI and you pay less interest over time when you're knocking down the principal like this.

I hope that mean navigating through this with you and everybody was helpful to see how I sort of deduct things. And in the end, I think you're going to get a little bit of everything. The weakest link is going to be the equity piece of this, but then it's your job to commit to building that up over the next few years. I don't see the value of your home plummeting tomorrow, right? If there is a correction in the market, it's probably going to be down the road and all the while, you're working hard to build up that equity, so you don't get yourself in a vulnerable place of becoming underwater. Thanks for your question.

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Next, let's help our Rachel who says that she's in the midst of a messy divorce. Long story short, there was fraud and she says,

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R: He took advantage of me financially for every penny and then some. I am now in credit card debt to the tune of $40,000. I'm 31 and I want to rebuild a new life and repair this step, but I'm on a fixed income at my job, and I don't make enough to get ahead of this with a high monthly payments and high interest rates. I've tried to ask all the credit card companies to increase my limits, and also to refinance the interest rates but no one is biting right now due to the high utilization. I really need to figure out how to get rid of this debt quicker, but I feel like there are no resources to assess my situation thoroughly. Are there any free financial advisors that I can talk to about putting together a plan that makes the most sense for debt consolidation and financial planning or credit repair?"

[00:22:50]

FT: Well, I'm so sorry to hear this. Thank you for reaching out. I do have a couple of websites that I highly recommend for anyone listening who's experiencing credit problems or debt management issues. You yourself have not been successful communicating with your creditors. There are two non-for-profit organizations, where you can hook up with license credit counselors for free for the first meeting. One is the National Foundation for Credit Counseling, nfcc.org, and then there's money Management International, moneymanagement.org. The first meeting is you talking about your situation with a credit counselor, and they're going to give you their true opinion and thoughts about how this can move forward. They're usually great in terms of being advocates for you, calling on your behalf and coming up with a debt repayment plan, but also assessing your budget.

These organizations also have debt management programs that do cost money, but they're pretty nominal. They're not going to cost you thousands of dollars. Typically, it's like $8 to $15, $20 a month. And if you're in real dire straits, you can ask to have those costs waived. There are so many companies out there that market debt consolidation, financial advocacy, they promise to get you out of debt quickly. But those programs usually cost a lot of money. It's not clear how it impacts your credit, so I don't really trust it off the bat. I do trust the National Foundation for Credit Counseling and Money Management International, so check out those two websites. I'll put them on our website as well, nfcc.org and moneymanagement.org. Good luck to you.

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Last question, a listener writes in and wonders if she can use two separate Roth IRAs. One that is hers and one that she inherited from her mother to use towards the purchase of a home. Now, just to give everybody some background on the Roth IRA rules for home purchases. The money that you contribute to your Roth IRA, that's money that you take from your checking account and you put into your Roth IRA, that can be withdrawn at any time for any reason. There's no tax, there's no penalty and you can spend that money however you like. If you want to take out the earnings, in that case, there are some rules. If it's been at least five years since you made your first Roth IRA contribution, only then can you pull out up to $10,000 in investment earnings tax and penalty free to put toward the first home.

This is just background. If it hasn't been five years, then you can still take out $10,000 of investment earnings, but you'll have to pay income taxes on the distribution. You don't have to worry about the early distribution penalty, but the taxes will still apply. Now, for the inherited Roth IRA she said, she wants to know when did you inherit the account. This is important. If it was inherited in 2020 or later, then you, my friend, needs to distribute the account within 10 years of the original owner's death, your mother's death. You do not pay taxes on the Roth IRA contributions, but if the five-year rule hasn't been met, then you have to pay taxes on the earnings. This again is for the purposes of withdrawing it towards the purchase of this home. But she did say, consult with a financial planner because this is very detailed. Glad that you brought it onto the show, but I'm that encourage you to now go speak to someone. On top of this, go talk to someone to really understand the precise steps that you are allowed to take with your mother's Roth IRA.

One other thing with regards to Roth IRAs and using your earnings towards a home purchase, is that you have to be a first-time homebuyer, which I believe this listener is. And the definition of a first-time homebuyer is that you or your partner, you haven't owned a principal residence in the past two years.

That's a wrap, everybody. Thanks so much for tuning in. I hope everybody has a good weekend, but we'll see you back here next week. We've got a great week lined up for you. My friend, Tiffany Aliche, The Budgetnista talking about her new book. I hope your weekend is so money.

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