



Questions and Answers for the 1973 Defined Contribution Loan Program

General Retirement Systems of the City of Detroit

This is a brief overview of the City of Detroit General Retirement Loan Program and is subject to change based on Board policy and Federal regulations

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Who is eligible for a Plan loan?

Any active general city employee (coded active and paid on City payroll) who is or has been a participant in the 1973 Defined Contribution Plan (annuity savings fund) may be eligible. These members are eligible to apply for a loan if the account balance in their 1973 Defined Contribution Plan is \$2,000 or more at time of application.

Additionally, you must be either a non-union employee or a member of a union that has formally adopted the provisions of the loan program and notified General Retirement Systems and Labor Relations with written notification of acceptance of the program.

How does taking out a loan impact my Plan investments?

Your loan is funded directly from your 1973 Defined Contribution Plan (annuity saving fund) account. The withdrawal will be deducted from funds in your account.

When you repay your loan, your loan payment is in after-tax dollars and is applied by the loan administrator to the loan interest and finally to the loan principal, thereby reducing the balance owed on the loan.

The money borrowed is not considered part of the Plan assets until repaid, and is ineligible for any special dividends or interest paid to the Plan.

What is the minimum amount of a loan?

The minimum loan amount available from the 1973 Defined Contribution Plan is \$1,000.

What is the maximum loan amount I can borrow?

The maximum loan amount a participant may obtain is one-half (50%) of the account value in the 1973 Defined Contribution or \$10,000, whichever is the lesser, inclusive of all outstanding loans from the Plan.

What amount can I borrow?

Loans may be made in any even dollar amounts from the minimum of \$1000 up to the maximum amount allowed.

May I have more than one loan at a time?

Yes. The plan now allows for up to two loans open at a time. If you originally borrowed less than the maximum

allowed, and now want to borrow up to the full amount, you may do so in a second loan. You may borrow until the total of the two loans is up to the maximum allowed. There is a 60-day waiting period from the date that one of the loans has been paid off, before a participant may apply for another loan. You may only be allowed to borrow in a second loan if you are current on the first.

The combined balance of your loans may not exceed your loan maximum which is the lower of one-half (50%) of the account value in the 1973 Defined Contribution or \$10,000 minus the highest balance owed on a loan in the last year.

What if I borrowed the maximum allowed in my first loan?

Once that original loan is paid down, you may borrow back up to the maximum if you so desire.

Do I have to put up collateral and qualify for a loan in the same way I would at a bank?

No, the remaining balance in your 1973 Defined Contribution Plan account will secure your loan.

How are loans treated for tax purposes?

Funds borrowed from the Plan under these conditions are not treated as distributions, **provided they are repaid in accordance with the terms of the Plan and the signed promissory note.** Therefore, no taxes are withheld or due when a loan is received.

May I deduct the interest I pay on the loan from my taxable income if I itemize deductions?

No. Under federal tax law, no deduction is permitted for interest paid on loans from the plan, regardless of the purpose of the loan.

Are there other tax issues I should be aware of?

The participant is strongly advised to address any questions regarding the tax consequences of loans or loan limits to a qualified, independent tax advisor before submitting an application for a loan.

How is the interest rate determined for Plan loans?

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The interest rates for Plan loans will be based on the actuarial assumed rate (the base interest rate you are paid in your annuity) plus 1% which shall be a loan administrative fee to cover the internal costs. The loan rate is fixed for the life of the loan.

Loans initiated at different times may bear different interest rates, where, in the opinion of the Board, the difference in rates is supported by a change in market interest rates or a change in the current assumed rate of return to the pension trust.

Bear in mind that the interest paid in by you, except for the 1% administrative fee, gets posted back to your account as interest with each payment.

It is essentially a self directed investment.

What is the current calculated interest rate?

The current loan rate based on the actuarial rate plus 1% would be 8.9%

What are the loan initiation and processing fees?

A loan origination fee in the amount of \$75.00 shall be deducted from each approved loan. A \$2.50 per payment processing fee will be added to each loan repayment amount to cover the third party administrator (TPA) fees. Also, a \$.30 fee is also added by the City's Payroll Audit department to handle each loan deduction. The TPA for the loan program is First Independence Bank.

What are the terms of the loan?

That depends on the type of loan. There are two types:

1. General Purpose Loan - A repayment period of one to five (1 - 5) years.

A General Purpose Loan can be used for any purpose. Proof of the reason for the Loan is not required.

Or

2. Residential Loan - A repayment period of one to fifteen (1 - 15) years.

A Residential Loan can be used only for the purchase or construction of a primary residence. Proof of purchase or a construction agreement is required.

Can I take a residential loan to refinance or pay off an existing mortgage?

No. Residential loans are *only* for home purchase or new construction.

The Participant Member can obtain a residential loan for constructing a new residence or purchasing an existing residence, but not for refinancing or repaying an existing mortgage, renovations, or buying out another person's share in their current residence or for the purchase of land only.

What are the loan repayment rules?

You are required to repay all your loans in full. Loans are due and payable upon the expiration of the loan term or your severance from employment with the City, whichever occurs first.

When you sign your loan documents, you must agree to a specific loan term. While you are actively employed, regular loan repayments for all existing loans must be made through payroll deduction.

Your repayments will be deducted from your paycheck on a bi-weekly basis, beginning shortly after you receive the loan proceeds.

Partial repayments may be made at any time to reduce the loan balance. You may also change your payroll deduction amount to increase your bi-weekly payment so that the loan is paid off early.

If you wish to fully prepay your loan, you may pay off your loan with a certified check or money order made payable to the First Independence Bank indicating the 1973 Defined Contribution Plan. Contact the Plan Administrator prior to submitting any full prepayment to confirm the total amount due.

What if I take a leave of absence?

Participants who take a leave of absence without pay for a period of greater than one month, but not exceeding one year may request that his or her loan repayments be suspended during the leave of absence through the submission of a Loan Change Form. Any delinquent payments owed as of the time of the participant's leave of absence must be made by the participant, or failure will result in a delinquency and possibly a default of their loan in accordance with IRS provisions.

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Interest will continue to accrue on all outstanding loans during the suspension period. The loan repayment period may not be extended but the loan payment(s) amount may be recalculated at the end of the participant's loan suspension period.

Another Loan Change Form must be submitted upon completion of the leave of absence to resume loan payroll deductions. Participants who take a leave of absence without pay for a period of one year or greater must continue to make loan payments, in accordance with the original loan repayment schedule, by submitting them directly to the Plan Administrator.

Upon submission of the Loan Change Form, the Plan Administrator shall send a request for loan payments directly to the participant's address on file with the Plan. Participants can make loan payments to the Plan via bank check or money order. Failure to submit a Loan Change Form may result in loan default.

If a Participant takes a leave of absence from the City of Detroit because of service in the military, and does not receive a distribution of his/her account, such time period shall not be taken into account as part of the loan period even if the length of military service is greater than the original term of the loan. Upon completion of military service, the loan(s) shall be recalculated and repaid over the original term of the loan(s).

Notwithstanding the above, during the military service period, the rate of interest shall not be greater than 6% compounded annually. You must submit a Loan Change Form prior to commencement of military leave and upon return.

What if I fail to make a required loan payment?

A participant will first be notified with a "Past Due Notice Letter" that the required loan payment was not made by the due date. This first occurs when two or more payments are missed. If the Plan Administrator does not receive the payment by the last day of the calendar quarter in which it was due, the participant's loan is delinquent and the Plan Administrator will send the participant a "Delinquent Status Letter". The "Delinquent Status Letter" is the second notice to the participant of the delinquency and the ability to cure the delinquency on or before default date. The default date is defined as the last day of the calendar quarter following

the calendar quarter for which the missed payment occurred.

To cure the delinquency, the participant must submit the amount due, via bank check or money order, directly, to the Plan Administrator in accordance with the cure period as set forth in the "Delinquent Status Letter".

A participant's default of one outstanding loan does not constitute a default of a second. A participant may continue to make loan payments on a second loan either via payroll deductions or with a certified check or money order made payable to the First Independence Bank indicating the 1973 Defined Contribution Plan at a Bank branch.

What are the consequences of a loan default?

If the Plan Administrator has not received the delinquent loan payment(s) by the date set forth in the "Delinquent Status Letter" (see definition in the answer to the question above), the loan is defaulted and the participant shall receive a "Notice of Default". The "Notice of Default" is a confirmation to the participant that the Plan Administrator did not receive the past due loan payment(s) to cure the delinquency by the specified date and, therefore, the following have taken place:

- The entire outstanding balance of the loan, including accrued, but unpaid, interest up to the date of default will be a deemed distribution and is includible in gross income, subject to mandatory federal withholding requirements and reported on Form 1099-R. You may also owe a penalty to the IRS for premature withdrawal if you are under 59 ½ in addition to the taxes owed.
- The participant will be precluded from applying for future loans from his or her 1973 Defined Contribution Plan account, even if the defaulted loan is fully paid off.

May I take another loan from my 1973 Defined Contribution Plan account?

A Participant Member may have two loans at a time. If your loan is still active you may have a second loan up to the maximum available.

There is a 60-day waiting period from the date that one of the loans has been paid off, before a participant may

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apply for another loan. You may only be allowed to borrow in a second loan if you are current on the first. The combined balance of your loans may not exceed your loan maximum.

A member may not borrow funds if they have ever defaulted on a 1974 Defined Contribution Plan loan in the past.

How do I estimate a loan repayment amount?

You can estimate a loan repayment amount to be about \$10 biweekly for each \$1000 borrowed for a general purpose loan where the payback is 5 years. The loan repayment amount may be estimated to be about \$5 biweekly for each \$1000 borrowed for a residential purchase loan where the payback is 15 years. The \$2.50 TPA fee and the \$.30 city fee are added to the loan repayment amount for each deduction.

If the required loan repayment amount would exceed 25% of your net pay the loan amount will be reduced till the required payment is below that threshold. Also, keep in mind that your minimum payment is \$20 biweekly regardless of the amount borrowed.

It's my money, why do I even have to pay it back?

Short Answer: The **IRS** rules require you to repay the loan.

Explanation: These monies are to be used for retirement and no taxes have been paid on the earnings. The Government wants to ensure that the funds YOU have set aside for retirement are there when you retire. It is the same reason that they charge a premature distribution fee for taking refunds out of the 1973 Defined Contribution Plan before you have reached retirement age.

Okay, so I have to pay it back, why can't I just offset the loan with the annuity (1973 Defined Contribution Plan) monies I have?

Participants are never eligible to directly "offset" their loans (payoff by using the remaining balance in the 1973 Defined Contribution Plan). The IRS would consider the offset a violation of the plan unless a member is eligible for an annuity refund.

What about an early refund, if I have a loan?

The 1973 Defined Contribution Plan does not allow in-service distributions except for the one time withdrawal after a member has reached 25 years of service.

However, participants that have an outstanding Plan loan balance will still be eligible for the twenty-five year one time in-service withdrawal providing they meet all of the following criteria:

- (a) The participant is currently employed as a city of Detroit employee.
- (b) The participant is current with their outstanding plan loan, and
- (c) The remaining balance in the participants account after the issuance of their 25-year benefit is not less than the outstanding loan balance at the time the benefit is paid.

What happens if I get disabled, there is a layoff, or I need to quit?

When a Plan participant experiences a severance from City service, the participant will be sent an "Employment Separation Letter" where they will be given a choice of having the loan treated as a "deemed distribution" which would result in a taxable distribution to the participant on a Form 1099-R for the outstanding loan amount.

Alternately, the participant can pay all outstanding loans **in full** in which case no taxable event for the loan would occur.

Disability retirement status shall be treated like a separation from service.

What if I decide to choose the 1998 Defined Contribution Plan (DC Plan) at some later date?

If you choose the 1998 Defined Contribution Plan at a later time the loan must be paid off or offset from the 1973 Defined Contribution Plan before any of your annuity monies are transferred to Great West (the 1998 Defined Contribution Plan Administrator). If the loan is offset from the 1973 Defined Contribution Plan you would be issued a 1099R.

I still feel I want a loan. How do I apply for a loan?

To apply for a loan, complete the Loan Application and submit it to the Plan's Administrative Office.

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What is the sequence of events in the loan process?

1. A completed 1973 Defined Contribution Plan loan application is received by the Plan Administrator;
2. The Plan Administrator verifies the participant's eligibility for a loan and the amount of the loan;
3. If verified, the Plan's record keeper issues a report to the Board which reviews the loan request and authorizes disbursement.
4. Subsequently loan proceeds are issued by the Bank to the participant (funds are disbursed at closing from the Bank to the participant usually within a week after the participants loan has been approved by the Board);
5. Repayments will be deducted from your paycheck on a bi-weekly basis, beginning shortly after you receive the loan proceeds.

Wait...have you considered everything?

Before deciding to take a loan from your 1973 Defined Contribution Plan account, make sure you understand how taking a loan can affect your retirement savings. Taking a loan from your 1973 Defined Contribution Plan account can greatly impact your future account balance. Therefore, you should consider other ways to cover your unexpected expenses.