CALIFORNIA 457 BENEFITS
Plan Administration & Investment Advice

Frequently Asked Questions about 457(b) Plan Loans

Who is eligible for a plan loan?

Any full-time employee of the City of Costa Mesa who has an account balance of $2,000 or more is eligible to apply for a loan.

What are the pros and cons of a plan loan?

There are both advantages and disadvantages to taking a loan against your account balance. Weigh these points carefully before making your decision.

Advantages

- No credit check is required to take a plan loan
- You are not taxed on a loan unless you default, i.e., fail to make repayments
- Competitive interest rates are paid back to your plan account instead of to a conventional lender
- Loan repayments are invested in your plan account funding selections
- Reasonable repayment terms

Disadvantages

- To fund a loan withdrawal, a portion of your Plan investments are sold. Consequently, you will lose the benefits of compounding gains and interest of these investments over time (see the illustration on page 2.)
- A plan loan could affect your ability to qualify for loans outside the retirement plan
- Repayments are made with after-tax dollars
- Loans must be repaid with interest
- A defaulted loan is considered a distribution, and is subject to tax reporting and income taxes

How do I apply for a loan?

To apply for a loan, complete a Loan Application available in the forms section of www.ca457.com and submit to CA 457 via fax: 949-367-1887 or email: nick@walkerfinancial.com.

What is the sequence of events in the loan process?

1. A completed loan application is received by CA 457;
2. CA 457 verifies the participant's eligibility for a loan and the amount of the loan;
3. Upon verification, CA 457 provides an amortization (loan repayment) schedule to the participant. A promissory note and Irrevocable Pledge and Agreement are sent to the participant for signature.
4. Participant signs and returns documentation to CA 457 via fax or email.
5. CA 457 directs our custodian, Charles Schwab Bank, to issue a loan distribution by wire or check (checks are mailed approximately one week after the participant has submitted the application to CA457);
6. Approximately one month following the month the loan was taken, the first recurring loan payment is due.

27201 Puerta Real ■ Suite 465 ■ Mission Viejo, CA 92691 ■ (800) 770-0457 ■
FAX (949) 367-1887 ■ www.ca457.com

How does taking out a loan impact my investments?

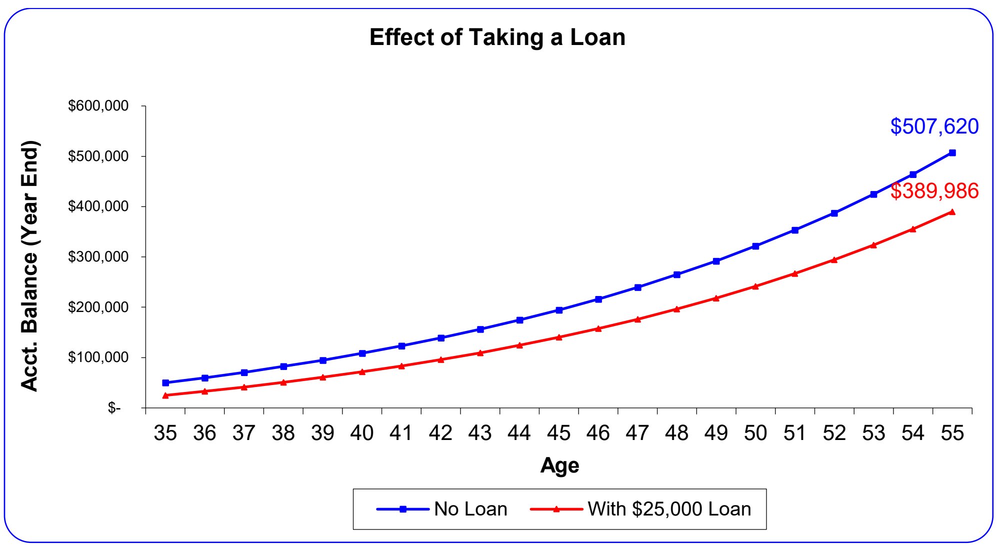
Your loan is funded directly from a cash-out of your pre-tax contributions in your 457(b) Plan account. The withdrawal will be deducted proportionately from all funds in your account.

When you repay your loan, your loan payment is in after-tax dollars and is applied to the interest and finally to the principal, thereby reducing the balance owed. Payments received on your loan will be directed to your current investment allocation in the applicable Plan and will be reflected on your statement.

How does taking out a loan impact my balance at retirement?

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

The following example illustrates how taking a $25,000 loan from your Deferred Compensation Plan account can impact your future account balance over 20 years. According to the example below, taking a $25,000 loan could cost you **$117,634**.



Assumptions:

- Current account balance is $50,000. The loan decreases beginning account balance to $25,000. Annual pre-tax contributions are $6,000.
- Annual rate of return is 8%. Borrowing rate is 7%.
- Annual loan repayment at 7% rate is $5,940 for five years. In order to stay cash flow neutral, participant stops regular pre-tax contributions for five years, then restarts regular annual pre-tax contributions of $6,000 for next 15 years.

What is the minimum amount of a loan?

The minimum loan amount available is $1,000.

What is the maximum loan amount that I can borrow?

The maximum loan amount a participant may obtain is the lesser of:

1. One-half of the account value in your 457(b) Plan reduced by the highest outstanding loan balance during the 1-year period ending on the day before the date on which such loan is going to be made; or

2. $50,000 reduced by the highest outstanding loan balance during the 1-year period ending on the day before the date on which such loan is going to be made.

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 457(b) account will serve as collateral.

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 loan. 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 a loan from the plan, regardless of the purpose of loan.

How is the interest rate determined for Plan loans?

The interest rates for Plan loans will be based on the Prime Rate + 1.00%. The Prime Rate shall be the prime rate published by The Wall Street Journal two weeks prior to the end of the most recent calendar quarter. CA 457 may adjust the loan interest rate for suspended loans to participants entering active duty in the military services as may be required by law.

What are the loan initiation and processing fees?

A loan origination fee in the amount of $90.00 shall be deducted from the participant's account at time of the application and a quarterly maintenance fee of $12.50 shall be deducted from the participant's account at the end of each calendar quarter.

What are the rules for repaying my loan?

You are required to repay your loan 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 agree to a loan term up to five years in length. While you are actively employed, regular loan repayments must be made from your personal checking or saving account held at a financial institution.

Your repayments will begin in the month following the month in which you receive the loan proceeds. If you wish to prepay your loan, it must be paid in full (no partial prepayments). Contact CA 457 prior to submitting any prepayment to confirm address and the total amount due.

What if I take a leave of absence?

Participants who take a leave of absence without pay must continue to make loan payments, in accordance with the original loan repayment schedule. A loan may be suspended only for participants who have entered active duty in the military services as required by law. In these cases, you must contact CA 457 to apply for suspension.

What if I fail to make a required loan payment?

A participant's loan shall be delinquent if any loan payment is not made on the date it is due and CA 457 does not receive the payment by the last day of the calendar quarter in which it was due.

If the loan is delinquent, CA 457 will send the participant a Loan Late Letter (the "Late Letter") notifying him or her of the delinquency and the ability to cure the delinquency and avoid default. To cure the delinquency, the participant must submit the amount due, via personal check, bank check or money order, directly, to the Charles Schwab Bank in accordance with the cure period as set forth in the Late Letter.

What are the consequences of a loan default?

If CA 457 has not received the delinquent loan payment(s) by the date set forth in the Late Letter (see definition in the answer to the question above), the loan is defaulted and the participant shall receive a Loan Defaulted Letter (the "Default Letter"). The Default Letter is a confirmation to the participant that CA 457 did not receive the past due loan payment(s) to cure the default 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 taxable distribution and reported on Form 1099-R. That amount will be included in the participant's gross income for the calendar year in which the cure period ended.
- The defaulted loan will continue to exist, and interest will continue to accrue until the defaulted loan is fully repaid or the participant experiences a distributable event.
- The participant is precluded from applying for future loans from CA 457 or any 457(b) deferred compensation provider of the City of Costa Mesa if there is an outstanding loan in default. Only when the defaulted loan is paid in full may the participant qualify for another loan. Transferring to another provider to apply for a new loan is not permissible.

CA 457 shall not be liable for any adverse tax consequences. The participant is strongly advised to address any questions regarding the tax consequences of loans and defaults to a qualified, independent tax advisor before submitting an application for a loan.

May I take more than one loan from my 457(b) account?

No. A participant may have only one outstanding loan at a time. Participants must repay any outstanding loan before applying for a new one. There can be no more than two loan applications in any 12-month period.

How may I locate my current loan balance?

Your loan balance is reported on the account statement that is mailed to you each quarter. Your current loan balance is available by contacting CA 457 or by logging into the Plan's Web site at www.ca457.com and clicking the Spectrum Pension Consultants (CA 457's record keeper) link.

How do I get more information?

Feel free to contact CA 457 at 800-770-0457.