

# RETIREMENT CHECK-UP



ANNE ARUNDEL  
COUNTY PUBLIC SCHOOLS

## Supplemental Retirement Benefits: The Consequences of Taking a Plan Loan or Hardship Withdrawal

When you need money today, saving for retirement may seem like something that can wait until tomorrow. Every year, AACPS employees take out loans against their Supplemental Retirement Program (SRP) benefits to pay medical bills, student loans, mortgages, etc. However, before you take out a loan against your retirement benefits, be sure to consider the true cost.

### Understanding the Cost of Loans

If you are enrolled in a 403(b) account through the SRP, you may request a loan of up to 50% of your account balance (minimum: \$1,000; maximum: \$50,000) from your 403(b) plan vendor. You can start the process by going through Retirement Manager. Note that loans are not available from SRP 457(b) accounts.

When you request a loan, you will be required to provide a reason for the request on your loan application. Keep the following in mind:

- **Your account balance is lowered by the loan amount** – and that affects investment earnings and compounding. You are selling shares of your account in order to have access to immediate cash.
- **You repay the loan with after-tax dollars.** While the contributions you make to your 403(b) account are made pre-tax through convenient payroll deductions, you pay the loan back with post-tax dollars – and you do not have the convenience of payroll deductions for repayments. You will have to make your repayments via electronic funds transfer or mailing a check.
- **You will be required to pay loan set up fees.** “Free” money is not free. Depending on your plan vendor’s procedures, you may have some costs to pay before you can access retirement funds.
- **You may only have one outstanding loan at a time.** If you are paying back your loan over a three-to-five year period, you may find yourself needing funds again, but you cannot take out another loan until the first loan has been paid in full.
- **Loan re-payments are an expense.** Some people end up reducing their contributions to the 403(b) plan to compensate for loan repayments. Lowered contributions ultimately affect your overall retirement benefit.
- **If you fail to repay your loan according to the loan policy your loan may be considered in default.** The IRS considers a loan in default a taxable distribution. That means, you’ll pay income taxes on the amount owed plus a 10% tax penalty if you’re under 59½.
- **The potential “opportunity cost” you face by borrowing from a 403(b) plan.** The cost of any potential return you’ll miss out on if the interest rate on the loan is lower than the account’s rate of return. For instance, if you borrow money from an account earning 10% and you pay 7% interest on the loan, you miss out on a potential 3% return on the balance of the loan. Over time, the missed earnings can add up and result in a lower balance in retirement savings. Also, keep in mind that returns in stock and bond markets are not constant—the average return is often earned in a few market surges occurring over a few days or weeks. If your plan money is out of the market when those surges occur, your opportunity cost could be much higher than you expected.

Remember, if you take a loan from your Supplemental Retirement Plan account, you are actually borrowing from yourself – not AACPS. It’s your money, so think carefully about how you spend and how you save it.

## Example: What Will It Cost Me?

Ed is age 35 and uses the 403(b) to save toward retirement. He currently contributes \$100 per pay period and has an account balance of \$50,000.

Ed needs \$10,000 cash and is considering taking a loan from his 403(b) account, which he would repay over five years at an interest rate of 5.3%. With the loan, Ed gets the benefit of using his \$10,000 immediately. However, Ed may give up much more than he realizes:

- With \$10,000 out of his account, Ed is going to lose out on investment earnings and compounding. Based on average returns of 8% and Ed's age, he'll miss out on an estimated \$6,800 because of this missed investment opportunity.
- If Ed suspends his contributions in order to afford the loan repayments over the next five years, the impact gets much worse – costing his account an estimated \$125,000 by the time he reaches retirement age.

Ed doesn't want to sidetrack his progress toward reaching his retirement goals, so he decides to also evaluate other sources for a loan. Though he might pay a higher interest rate on a personal loan from a bank, it may be the better bargain in the long run.

If you want to consider a loan, be sure to think about how it fits with your financial plans.

Loans and hardship withdrawals require a certificate from Retirement Manager. Go to <https://www.myretirementmanager.com/retireman/>

## Take Advantage of Tax Saver Credit

Did you know that you could be eligible for an additional tax credit on your income taxes if you participate in the Supplemental Retirement Program?

According to IRS regulations, employees who save for retirement in qualified programs such as the 403(b) or 457(b) are eligible to claim a tax credit. The amount of the credit is 50%, 20% or 10% of your retirement plan contributions, up to \$2,000 (\$4,000 if married filing jointly), depending on your adjusted gross income (AGI). See the chart to calculate your credit. Ask your advisor for more information.

### 2014 TAX SAVER'S CREDIT

Credit Rate	Married Filing Jointly	Head of Household	All Other Filers*
50% of your contribution	AGI not more than \$36,000	AGI not more than \$27,000	AGI not more than \$18,000
20% of your contribution	\$36,001 - \$39,000	\$27,001 - \$29,250	\$18,001 - \$19,500
10% of your contribution	\$39,001-\$60,000	\$29,251 - \$45,000	\$19,501 - \$30,000
0% of your contribution	more than \$60,000	more than \$45,000	more than \$30,000

## HARDSHIP WITHDRAWALS

If you are experiencing a true financial hardship, you may be able to request and receive retirement funds through a hardship withdrawal. Unlike a loan, you do not pay back hardship withdrawals. Before requesting a hardship withdrawal, you must first attempt to satisfy the financial need by other resources that are reasonably available to you. Eligibility for a hardship withdrawal is based on IRS regulations, which allow hardship withdrawals for the following only:

- Medical expenses for you, your spouse, or your dependent (or primary beneficiary other than your spouse if your plan allows).
- Expenses directly related to the purchase of your principal residence, excluding mortgage payments.
- Tuition-related educational fees, including room and board for the next 12 months for post-secondary education for you, your spouse, your children, or your dependents (or primary beneficiary other than your spouse if your plan allows).
- Amounts required to prevent eviction from, or foreclosure on, your principal residence.
- Burial or funeral expenses for your deceased parent, spouse, child, or dependent (or primary beneficiary other than your spouse if your plan allows).
- Repairs for uninsured or underinsured damage to your principal residence due to theft, fire, storm or other casualty.

Note: You will be required to furnish proof of your hardship to your SRP provider, along with your withdrawal application.

The amount provided through the hardship withdrawal must come from available retirement funds and be sufficient to satisfy the amount of the financial need. Future payroll contributions must cease for six months after requesting the withdrawal. If you take a hardship withdrawal and are under the age of 59 ½, you may be subject to a 10% federal tax penalty on the amount withdrawn.

For more information on hardship withdrawals, contact your Supplemental Retirement Plan provider.