



CITY OF BETHLEHEM

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To: Michael G. Colon, President of City Council

From: Eric R. Evans, Business Administrator

RE: Change of method to determine actuarial value of assets for fire and police pension funds

Date: February 14, 2024

During the budget hearings last fall, we repeatedly referenced a concern that pension payments (MMOs) will increase in 2025, due to the performance of the markets in 2022. We have received information from our actuary, and agree with their recommendation to change the method of how the actuarial value of assets is determined, which will reduce the impact to our 2025 budget.

Under Act 205, cities jointly set the actuarial assumptions for their pension funds with their actuaries. As such, we have reviewed and discussed the actuarial assumption options for the new valuations with our actuary. The asset valuation method used in the actuarial valuations as of January 1, 2021, is the market value of the plan assets. The City could continue using the market value of plan assets in the January 1, 2023, actuarial valuations. Alternatively, due to the down markets in 2022, the City may elect to change the asset valuation method to asset smoothing, which would lessen the impact of the 2022 market performance and spread the relating contribution increases over five years.

While asset smoothing is best used as a long-term methodology to achieve the benefit of limited volatility in funding levels and contributions from year to year, there is no requirement to remain with this method for any length of time. The City previously moved to asset smoothing in 2010, after the financial crises of 2007-2008 that caused the markets to retreat in 2008-2009. The City then moved back to market value in 2014, when the markets recovered. Under Act 205, valuations are completed every-other-year, so we do plan to review these same options again in 2026. The fact that our portfolio finished strong in 2023, the 2024 final results will determine the proposal at the time. (Of note, the pension funds have returned 8.1% annually for the 7-year period ending December 31, 2022, and 8.3% since inception of the funds in January 1988, both outperforming all comparable public defined-benefit plans.)

Fire Pension Plan Actuarial Results

The funding percentage declined from 91.3% as of January 1, 2021 to 87.8% as of January 1, 2023. (The funding percentage under the asset smoothing methodology would be 92.1%.) This is due to primarily to the investment losses over the prior two-year period. The investment returns were 15.8% in 2021 and -9.2% in 2022. Although the portfolio is insulated and diversified, it was not able to fully avoid the influence of market-wide conditions that were experienced in 2022. When compared to the 7.0% plan assumption each year, it resulted in an actuarial loss. The actuarial losses and decreased funding status results in an increased contribution level. With no assumption changes and the draft results as is, the 2025 MMO is expected to be approximately \$3,430,000. This is approximately \$738,200 higher than the current 2024 MMO (\$2,691,838).

Police Pension Plan Actuarial Results

The funding percentage declined from 78.4% as of January 1, 2021 to 72.6% as of January 1, 2023. (The funding percentage under the asset smoothing methodology would be 76.1%). This is due to primarily to the investment losses over the prior two-year period. The investment returns were 15.8% in 2021 and -9.3% in 2022. Similar to the Fire Plan, the Police Plan is insulated and diversified, but was not able to avoid the influence of market-wide conditions in 2022. When compared to the 7.0% plan assumption each year, it resulted in an actuarial loss. The actuarial losses and decreased funding status results in an increased contribution level. With no assumption changes and the draft results as is, the 2025 MMO is expected to be approximately \$7,515,000. This is approximately \$1,528,700 higher than the current 2024 MMO (\$5,986,328).

The results from the 2023 actuarial valuations will be used to determine the minimum municipal obligations in future years, starting in 2025. The minimum municipal obligations for 2024 were calculated in the fall of 2023. The following table compares the market value of plan assets to asset smoothing as-if the 2023 actuarial valuations were used to determine the 2024 MMOs. The calculations for the 2025 MMOs are tentative, but do provide an accurate estimate for our 2025 budgeting purposes. The final calculations for the 2025 MMO cannot be completed until September, when all participation and actuarial data is available.

Plan	Actual 2024 MMO	2023 Valuation <u>Market Value</u> MMO	2023 Valuation <u>Asset Smoothing</u> MMO	2023 Valuation Difference in <u>Asset Method</u>
Police	\$5,986,328	\$7,515,000	\$6,965,000	\$550,000
Firemen's	<u>\$2,691,838</u>	<u>\$3,430,000</u>	<u>\$2,985,000</u>	<u>\$445,000</u>
Total	\$8,678,166	\$10,945,000	\$9,950,000	\$995,000

The attached resolution proposes the adoption of the five-year asset smoothing method to calculate the actuarial value of assets as part of the actuarial valuations for the City of Bethlehem Firemen's Pension Fund and the City of Bethlehem Police Pension Fund. The impact of the asset smoothing, if used for the 2023 valuations, would result in increased funding percentages and decreased expected 2025 MMOs, as illustrated in the table above.

If the City chooses to adopt the asset smoothing methodology for the January 1, 2023 valuations, it is required to obtain and present a resolution from City Council to the actuary in February, as the valuations and Act 205 forms need to be prepared, then submitted to the State by March 31, 2024.

RESOLUTION NO. 2024-_____

A Resolution of the City of Bethlehem, Northampton County, Pennsylvania, adopting a five-year smoothing method to determine the actuarial value of assets as part of the actuarial valuation for the City of Bethlehem Firemen's Pension Fund and the City of Bethlehem Police Pension Fund, according to §203.2 of the regulations covering the implementation of the actuarial funding rules of Act 205 of 1984 (P.L. 1005, No. 205, 53 P.S. §§895.101-895.803) published by the Public Employee Retirement Commission, currently known as the Municipal Pension Reporting Program (MPRP).

WHEREAS, the City of Bethlehem has previously submitted the actuarial valuation reports for the City of Bethlehem Firemen's Pension Fund and the City of Bethlehem Police Pension Fund using the fair or market value of plan assets to determine the actuarial value of assets; and

WHEREAS, the City of Bethlehem desires to use a five-year smoothing method to determine the actuarial value of assets, effective with the January 1, 2023, actuarial valuation; and

WHEREAS, the City of Bethlehem desires to adopt a method for valuing assets for actuarial valuation purposes under §203.2 of the regulations cited above as determined by the Plan's actuary; and

NOW THEREFORE, be it resolved and enacted by the City of Bethlehem that the five-year smoothing method to determine the actuarial value of assets be adopted for the Plan, effective with the January 1, 2023, actuarial valuation report.

Sponsored by _____

ADOPTED by Council this day of , 2024.

President of Council

ATTEST:

City Clerk