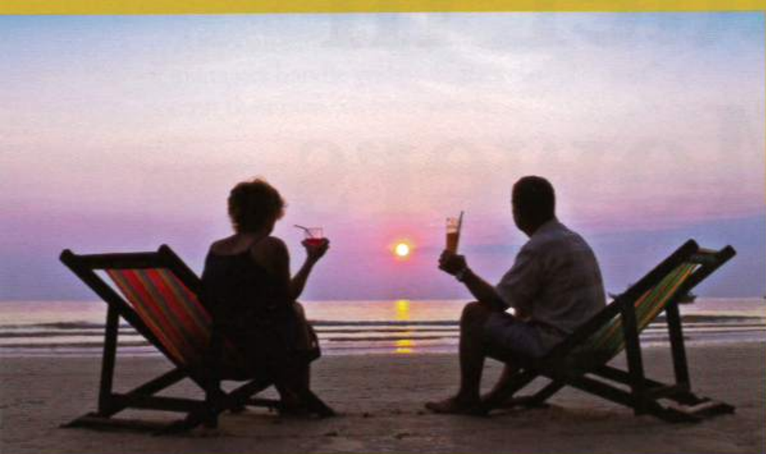
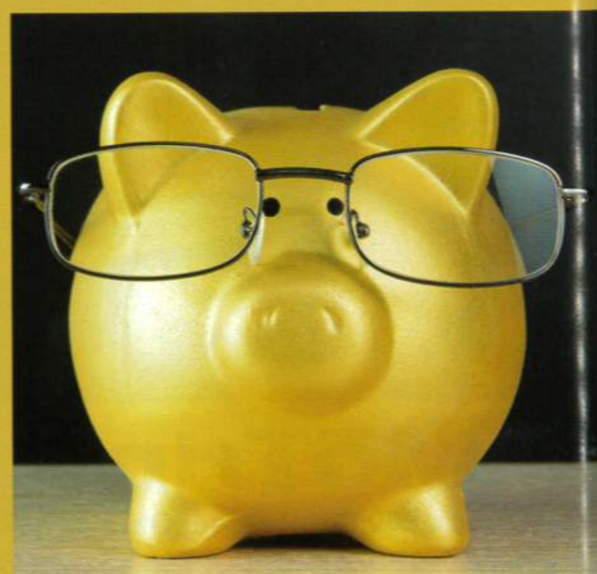
SECURING YOUR EMPLOYEES' NEST EGG





Townships Can Keep Pension Plans Healthy with Adequate Funding and Some Key Strategies

Funding a pension plan is a little like steering a ship across the ocean. You are sure to encounter both stormy and smooth seas. Whether pension funds are benefiting from rock-star market growth like they have been of late or have taken a hit from a prior sagging economy, townships should not get too excited or nervous either way. Instead, keep a steady course, strategize with your pension advisers, and continue socking funds away. **Your employees' financial future, after all, depends on it.**

BY **AMY BOBB** / ASSISTANT EDITOR

In case you haven't heard, the stock market has been doing well.

So well, in fact, that underfunded pension plans — a frequent target of media attention and legislative scrutiny — are even less of an issue for townships, whose plans are historically well-funded and managed.

"Currently, the economy is in an expansion period," says Joe Bonasera, president of Summit Financial Corporation, which administers PSATS' Trustees retirement plans. "The market has been really strong, and it's been an incredible run."

Such good news bodes well for pension plans, which are typically funded through investments that rely on stocks and bonds to increase their value. However, if the economy tanks, the funding of pension plans can suffer, too. When the stock market collapsed in 2008, pension funds lost as much as 40 percent of their value. Since then, the economy has rallied, and pension plans have been reaping the rewards.

Market fluctuations are an expected part of the cyclical U.S. economy, Bonasera says.

"There will be periods when the value of a pension plan's assets is reduced and other times when it goes really high, like we've seen of late," he says.

"Still, townships shouldn't be concerned," Bonasera says. "They must keep in mind that they are funding their pensions for the long haul."

Instead of getting caught up in market volatility and overreacting to gains and losses, keep a steady course and follow sound pension advice, he says. By understanding how pensions work, making minimum recommended payments, and adding additional funds when possible, townships should be able to meet their obligations and help to secure a nest egg for loyal employees.

Funding pensions

Antrim Township in Franklin County has had an employee pension plan since 1989. In the past 30 years, it has built up its assets to nearly $3 million, and the plan is 120 percent funded, according to 2017 statistics from the state Auditor General's office, which monitors the financial health of municipal pension plans.

There's no real secret to the township's success so far, manager Brad Graham says.

"We always make sure to put in our

"A pension is like making a mortgage payment. You are required to make an annual payment **to work toward fully funding your pension fund."**

"Townships must keep in mind that they are **funding their pensions for the long haul.**"

minimum payments to keep it funded," he says.

Pension experts agree that this strategy is key to keeping plans solvent. While pension funds are subject to such outside forces as market fluctuations and investment changes, townships must learn to be disciplined and continue to pay their annual minimum municipal obligation (MMO), an amount calculated by an actuary to ensure that pension plans are fully funded.

The MMO will fluctuate, of course, depending on how pension investments are doing. If investments fall short, the MMO will spike.

For the most part, making this payment helps to keep municipal pension plans on financial track. Consider that the state, which is not mandated to make such minimum payments, has not fared as well, accumulating around $74 billion — and climbing — of unfunded liabilities in the state employees' and public teachers' retirement plans.

In contrast, the roughly 1,200 pension plans belonging to townships of the second class are cumulatively funded at around 89 percent, according to the Auditor General's 2017 figures, with nearly $2.2 billion in total assets and almost $2.5 billion in liabilities, leaving an estimated $268 million unfunded.

"Most townships are diligent about funding their retirement accounts for their employees," Bonasera says.

He blames larger municipalities, most notably Philadelphia and Pittsburgh, for shirking their pension obligations and kicking the can down the road. As of last year, Philadelphia had funded just 45 percent of its nearly $11.3 billion pension liabilities, while Pittsburgh was in only slightly better shape with assets covering 56 percent of its roughly $1.3 billion liability. Such a strategy has created huge deficits that, along with the state employees' and public teachers' shortfalls, have raised a red flag in recent years about public pension plans.

Unfortunately, such headline-grabbing news has overshadowed the due diligence of most townships, Diane Calhoun, manager of PSATS' Municipalities Pension Trust, says. Overall, township plans are actuarially sound, she says, and township officials take the necessary steps to keep their plans on track.

"A pension is like making a mortgage payment," Calhoun says. "You are required to make an annual payment to work toward fully funding your pension fund. Our townships understand this."

Distress Levels of Pension Plans — Townships of the Second Class

	2012		2018	
Distress Level	**# of Twps.**	**% of Twps.**	**# of Twps.**	**% of Twps.**
None (0) Funded 90% or greater	261	48.79%	329	61.50%
Minimal (1) Funded 70-89%	202	37.76%	176	32.90%
Moderate (2) Funded 50-69%	54	10.09%	28	5.23%
Severe (3) Funded less than 50%	18	3.36%	2	0.37%

Source: Municipal Pension Reporting Program, Department of Auditor General

Stronger pension health

Calhoun credits Act 44 of 2009, which provides a means for verifying the health of municipal pension funds, with helping townships better comprehend where they stand when funding their plans. Under the law, municipal pension plans are reviewed every two years by the Municipal Pension Reporting Program of the Auditor General's office, which assigns each plan a distress score, based on funding deficiencies, of zero *(not distressed: assets exceed 90 percent of liabilities)* to three *(severely distressed: assets are less than 50 percent of liabilities)*. Plans in high distress must take remedial measures to restore their financial health.

Between 2012 and this year, the number of severely distressed pension plans for townships of the second class has dropped from 18, or 3.36 percent, to two, or .37 percent. Likewise, the number of plans with a zero rating has increased from 261, or 48.79 percent, to 329, or 61.5 percent. *(See box at left.)*

"Since the state started providing distress rankings for plans, townships have become more aware, and many have put extra money toward their pension accounts," Calhoun says.

Salem Township in Wayne County received a level-three distress ranking in 2012 when its pension assets were at $77,575, well short of its $173,636 in liabilities at the time. The township got to work turning this around, and by 2017, it had raised its distress level to a one with $282,556 in assets, $322,157 in liabilities, and an 88 percent funded plan.

"The score will be at a zero soon," secretary-treasurer Jennifer Wargo predicts, "as long as we continue what we're doing — being fiscally responsible and not getting in debt. The key is we don't spend what we don't have."

To get ahead, the township has been using the annual pension aid it receives from the commonwealth to make extra payments into its pension fund. The state payment to Salem Township this year amounted to close to $9,369, Wargo says, a nice sum to add to the township's MMO funds of $18,131.

Derived from a tax on out-of-state insurance companies, state aid funding helps to offset the costs of retirement benefits for uniformed and non-uniformed municipal employees. To qualify for state aid, municipalities must have had a pension plan in place for at least three years.

In 2018, state aid to municipalities amounted to nearly $300 million. While the total allocation of state assistance continues to steadily increase, the dollars don't stretch as far as they used to when covering municipal pension costs. In 1989, state aid fully covered 96 percent of municipalities' pension costs. By 2016, that number had dropped to 42 percent.

Although townships are not obligated to deposit their state aid checks in their pension account — many prefer to put the money back in their general fund as reimbursement for pension funds they may have already paid out — their plans will be in a much better financial position if they do, Bonasera says.

"Not all municipalities have the financial ability to do that," he acknowledges, "but whatever they can do to additionally fund their plan will help to make their pensions stronger."

Keeping a promise

The number of local government pension plans in Pennsylvania continues to steadily climb, increasing from 1,991 in 1978 to 3,323 last year. The number grows due to a variety of plan offerings, as well as separate plans for some unionized workers.

Without a doubt, pensions have become an important part of an employee benefits package. A solid pension plan

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helps to attract good employees and rewards those who stay for the long term.

Once employers offer a guaranteed pension payment to retirees, state law and court rulings dictate that this promise cannot be broken. Township officials should therefore become educated on pension plans, know the benefits they are providing employees, and understand how pension costs will affect their township's bottom line.

Historically, pensions referred to defined benefit plans in which eligible employees are provided a specific guaranteed payment at retirement based on years of service, annual earnings, and retirement age. Under state law, municipalities with at least three police officers must provide them with a defined retirement benefit, which is negotiated through a collective bargaining agreement.

Defined benefit plans can be costly and burdensome for the employer, who must provide the funds and decide how to invest them to fully cover their retirees' pensions. If investments fall, for example, the employer must contribute more to make sure the fund can meet its future obligations.

Townships of the second class have traditionally offered defined benefit plans for their employees — around 60 percent of township pension plans were classified as defined benefit in 2017 — but some have begun to embrace a national trend to shift instead to defined contribution plans.

Since 2003, the number of defined contribution plans for townships has increased by about 25 percent, while the number of defined benefit plans has only risen around 7 percent, according to the Auditor General's office. About 3.5 percent of township pension plans overall have swung from traditional defined benefit to defined contribution. *(See the box on page 28.)*

With a defined contribution plan, both the employer and employee make periodic payments to an investment account, and benefits are based on the actual amount in the account at the time of withdrawal. With this type of plan, townships do not incur any unfunded liability because they no longer have to ensure that they have enough money socked away to cover their retirees' payments. Instead, the employee takes on more risk in managing his or her retirement benefits.

"We are seeing a trend of more townships going this route," Bonasera says, "but what they do not realize is that they may create a situation where they still incur costs and liabilities."

For example, he says, employees who cannot afford to retire will continue to work, and townships may face the consequences of having to pay higher salaries and health care costs while potentially seeing lower productivity that can sometimes occur as employees age.

A more balanced option, Bonasera says, is for townships to offer employees

"Whatever townships can do to additionally fund their plan **will help to make their pensions stronger."**

both defined benefit and defined contribution plans. A defined benefit plan gives employees the peace of mind of a regular paycheck for life, while a defined contribution plan makes the participants responsible for a portion of their retirement funding.

According to the Auditor General's office, Hanover Township in Washington County has a well-funded pension plan — as of 2017, it was 91 percent funded with $357,740 in assets and $390,904 in liabilities. When employees complained of the low payments they were expecting in retirement, the board of supervisors sat down with a benefits consultant and looked for ways to improve what it offered while staying fiscally responsible to taxpayers.

The township, which joined the PSATS Trustees Insurance Fund and Retirement Services in 2008, recently decided to add two new plans: a 457 supplemental plan that allows employees to voluntarily save for retirement and a 401(a) defined contribution plan that new-hires will be provided instead of the township's traditional defined benefit plan. *(See box on page 30 to understand the various plan options available from the PSATS Trustees program.)*

"These changes will offer additional pension opportunities while putting more responsibility on employees to save for retirement," secretary-treasurer Audrey Wingard says.

"You don't want to agree to pension changes and then find out later that what you just **agreed to is neither affordable nor advisable."**

The Shift in Pension Plans — Townships of the Second Class

	DEFINED BENEFIT*		DEFINED CONTRIBUTION**	
Year	**Number of Plans**	**% of Total**	**Number of Plans**	**% of Total**
2017	724	60.38%	439	36.61%
2003	676	63.83%	352	33.24%

* The statistics in this category do not include split-funded plans, which function like a defined benefit plan but also include insurance/annuity contracts that are maintained pre-retirement to fund a portion of the benefits. Among townships of the second class, there were only three (.28%) of these plans in 2003 and just one (.08%) in 2017.

** The statistics in this category do not include "union" pension plans, which are provided through participation in a multi-employer, jointly trusted, union-administered plan *(through Taft-Hartley Act collective bargaining)*. Among townships of the second class, there were 28 (2.64%) of these plans in 2003 and 35 (2.92%) in 2017.

Source: Municipal Pension Reporting Program, Department of Auditor General

Rely on your advisers

When making decisions about retirement plans, townships should seek the advice of professionals who are experienced with municipal pension programs and can offer sound yet affordable assistance. A solid team of advisers includes an actuary, a pension plan administrator, and a labor attorney.

Many factors can influence a pension fund's solvency, but it's the actuary's job to calculate certain assumptions, most notably how well the fund's investments will do and how long an employee will live, and then figure out the dollar amount, or MMO, a township must contribute each year to keep the plan afloat.

Pension plan administrators and consultants provide advice on plan options and investing. Together, an actuary and plan adviser can help to minimize risk by structuring an investment portfolio and payment amounts that will meet the financial needs of current and future retirees.

"A township should sit down with its pension advisers and discuss the pros and cons of different plans, learn how they work, and then decide which ones will meet its goals and objectives," Bonasera says.

He encourages townships to invest in a diversified portfolio of stocks and bonds, which historically has provided a better rate of return over the long run than funds placed in a fixed-growth account.

"But it will make for a bumpier ride, and some officials never want to see a situation where their funds go down," he says. "We try to make them aware, however, that being fiscally diverse will pay better over the long haul."

Finally, an attorney versed in pension trends, laws, and court rulings can be an integral member of a township's team of advisers, especially when it's time to negotiate a collective bargaining agreement for uniformed employees. Mandatory pension benefits for police and firefighters, after all, can take a huge bite out of municipal budgets.

Advisers help to make sure townships are not making promises that they cannot keep or afford. An example would be providing past service credits to participating employees.

"Giving past service credits creates a large liability that must be paid off over the remaining working life of the employee, which averages less than 15 years," Brian Bowers of the Municipal Pension Reporting Program of the Department of Auditor General says. "A shorter working life increases the amortization payment, thus increasing the municipality's MMO."

Townships must also keep in mind that although pension funds are reaping the benefits of a healthy economy today, good times don't last forever. When negotiating pensions for uniformed employees, for example, be wary of negotiators trying to seize upon an upswing in pension funds to seek enhanced benefits, Eric Brown, a partner in Siana Bellwoar in Chester County, says.

During recent negotiations, Brown, who specializes in employment and labor law, has observed an uptick in requests to either add new pension benefits or suspend or limit employee contributions to plans.

"Most of the pension funds I've seen in the last couple of months are doing quite well," he says. "When meeting with union representatives, townships need to remind them that times are not always this good."

Don't dig yourself a benefit hole by agreeing to something that will be difficult to keep funded, especially once investments start to lose ground again. Brown advises sitting down early with professional advisers to grasp the costs of pension benefits and understand what alternatives, if any, may be available.

For example, he says, instead of agreeing to a request to eliminate the employee contribution to a pension plan, a township may want to consider a temporary suspension for one year only.

"These are the kinds of discussions you need to have with your professional advisers," he says. "You don't want to

"There will be periods when the value of a **pension plan's assets is reduced and other times when it goes really high,** like we've seen of late."

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agree to pension changes and then find out later that what you just agreed to is neither affordable nor advisable."

Meet with your pension team at the beginning of the calendar year in which an employee contract is set to expire, Brown says. Evaluate the condition of the fund, and once you receive an initial collective bargaining proposal, identify any pension-related requests. Then, be sure to ask your actuary for a cost study before making any changes to the pension plan. Actuaries are usually willing to provide studies containing several options, he says.

"Before creating any new benefits in the plan or agreeing to such things as COLA [cost-of-living adjustments] or step increases, you should have an actuarial cost study done," Brown says.

"A township should sit down with its pension advisers and discuss the pros and cons of different plans, learn how they work, and then decide which ones will meet its goals and objectives."

He advises consulting with your labor counsel to determine when an actual study should be discussed during negotiations.

Collective bargaining is also a good time to review the Auditor General's biennial report, Brown says, and make sure the township's pension plan is consistent with any collective bargaining agreement or employee contract, as well as state and federal laws.

* * *

Without a doubt, pension plans can be a challenge for townships to manage. They require you to predict the future, and a lot can happen between today and when retirement liabilities come due. However, by staying on top of their contributions and following the advice of pension professionals, townships can rest assured that their plans will be healthy and solvent and ready to meet the obligations of today and tomorrow.

"Above all, you want a plan to fit your budget," Bonasera says. "You want to make sure it's affordable, and you have to stay disciplined both in funding and investing it. If you do those things, the plan will work just the way you want it to." ✦

PSATS pension programs help meet township employees' retirement needs

PSATS' Trustees Insurance Fund and Retirement Services has been helping townships administer pension plans for nearly five decades.

In addition to traditional defined benefit plans, Trustees also offers the following:

• **Defined contribution plan** — The 401(a) plan, the most recent addition to the Trustees' menu of offerings, is a money purchase plan in which the township contributes a fixed percentage of an employee's pay or a flat dollar amount.

The employee controls the investments, which relieves the township of the responsibility of monitoring the investment portfolio. Townships may determine who is eligible to participate in the plan. After three years of funding the plan, the employer portion is eligible for Act 205 state aid reimbursement.

• **Retirement savings plan** — The 457(b) plan is a savings plan designed to supplement a township's current pension plan. It can be paired with either a defined benefit or defined contribution plan to help employees save for retirement.

The plan allows for either traditional pre-tax or Roth contributions. With the Roth option, taxes are deducted now so that the employee enjoys tax-free growth and distribution at retirement. Participants can choose to manage their own 457 funds or go with a "do-it-for-me" approach, in which they elect to use a "target maturity" portfolio based on their anticipated year of retirement.

PSATS administers its pension plans in partnership with Summit Financial Corp. of Burlington, Mass., and Nationwide Financial Services. To learn more, call Trustees Insurance and Retirement Services toll-free at (800) 382-1268.

With wise advice and sound decisions about pension plans, townships can help employees prepare for their "golden years."