

December 1, 2025

Ms. Bina Patel
 Director of Finance
 City of Allentown
 435 Hamilton Street, Room 227
 Allentown, PA 18101

Re: Allentown Police Pension Plan DROP – Act 205 Cost Study

Dear Bina,

As requested by the City of Allentown (the City) and the Fraternal Order of Police (FOP) Lodge No. 10, we are providing an estimated cost impact of changing the City of Allentown Police Pension Plan (the Plan) to provide a Deferred Retirement Option Program (“DROP”) as described in the “Memorandum of Agreement (MOA) Regarding DROP” as provided in the document “Allentown FOP MOU 11.17.25” on November 18, 2025 to Cheiron. As requested by the City, this cost study provides the cost impact for the following scenarios:

- Scenario #1: Assume all police officers are eligible to participate in the DROP Program when they attain 20 years of service, including purchased service such as prior military service, prior police service from another police department as provided by Act 49, or other service with the City. Participants are assumed to enter the DROP based on the current retirement assumptions.
- Scenario #2: Same as Scenario #1 except assumes 100% of participants will elect the DROP when first eligible to retire upon attainment of 20 years of service, which includes the purchased service.

Summary of Results

Table I below summarizes the results from this cost study using the January 1, 2025 actuarial valuation results as the Baseline. Scenario #1 and Scenario #2 are described above.

Table I			
High Level Summary for Impact of Plan Change [shown in Millions (\$)]			
	Baseline	Scenario #1	Scenario #2
Unfunded Liability (UAL)	\$ 27.4	\$ 36.1	\$ 51.5
AVA Funded Ratio (%)	89.8%	87.0%	82.4%
Estimated 2026 MMO	\$ 9.5	\$ 10.6	\$ 12.3

The cost impact above does not reflect the employee contributions to purchase service. In total, assuming all participants immediately purchase all service (i.e. military service, Act 49 service, and “other service with the City” as referenced in item 4 of the MOA) up to five years per participant, then the employee contributions from purchased service may range from about \$2.0 million to \$3.0 million. This will decrease the UAL directly by this amount and decrease the estimated 2026 Minimum Municipal Obligation (MMO) about \$0.3 million to \$0.4 million.

Furthermore, under Scenario #2, once DROP participants resign from employment over the next five years, the MMO may gradually increase as payroll increases from new hires replacing resigned participants. The estimated MMO will be \$13.4 million after five years, assuming all payroll reverts to the payroll used to determine the 2026 MMO by the City (i.e. \$23.9 million) and participants continue to enter the DROP immediately upon attaining 20 years of service.

The remainder of this letter provides the details associated with this cost study including potential variations of the actual actuarial impact due to changing participant behavior, interest rate risk associated with the DROP account or other changes that may not be anticipated.

Plan Provisions

In general, eligible participants for the DROP Program will accumulate their monthly retirement benefits in a DROP trust fund while delaying their resignation up to 60 months from the date they entered DROP. The monthly retirement benefit is equal to the amount the participant would have received had they retired at the time they entered the DROP Program. When the participant elects to exit the DROP Program, the participant receives the amount accumulated in the DROP trust fund in a lump sum and begins receiving their normal monthly retirement benefit.

In addition, we followed the provisions below:

- DROP trust fund balances earn the minimum of 0% per year and the maximum of 4.5% interest per year. The interest rate per year will be based on the investment return of the Market Value of Assets of the City's Police Pension Fund.
- Participants will not make employee contributions once they enter the DROP Program.
- Eligibility for the COLA provisions of the Plan becomes effective on the date a member enters DROP.
- Survivors or beneficiaries will receive the entire DROP trust fund balance if the participant dies before exiting DROP. Normal form of payment options is then used to determine any additional benefits payable to the beneficiaries.

The DROP Program created shall begin not later than 12:01 a.m. as of December 1, 2025. Once a police officer commences participation in the DROP, his or her election to participate shall become irrevocable, and he or she may not choose to resume active participation in the Plan nor resume earning pensionable service credit. Finally, note that to participate in the DROP, a City police officer must have 20 or more years of pensionable service to the City. "Pensionable service to the City" shall include purchase of non-intervening military service or purchase of previous police or other service with the City.

On the next page is a chart of the different types of service that a participant can purchase based on our understanding of the plan provisions and the MOA. Participants may combine purchasing service from the various plan provisions, but the total purchased service per participant cannot exceed a combined maximum of five years.

Plan Provision	Vesting Requirement	Maximum Service Purchase	Cost to the Employee
Military Service	None	5 years	Employee Contributions (no interest) plus an additional amount based on the City Plan contributions for the Calendar Year associated with the purchase service year
Service earned with prior police (“Act 49”)*	12 years	5 years	Follows Act 49 purchase service cost
“Other service with the City”**	None	4 years	Employee Contributions (no interest)

* It is our understanding that the purchase of prior Act 49 service is in arbitration and is currently not eligible to be purchased, but we are including this in the cost study as if it is available for purchase under the Plan as instructed by the City.

**It is our understanding that other service with the City is currently not eligible to be purchased, but we are including this in the cost study as if it is available for purchase under the Plan as instructed by the City.

As directed by the City, this cost study does not include analysis of the cost of the potential Plan change allowing participants to purchase other service with the City under the Plan.

Plan Change Impact on the Pension Liabilities and MMO

Table II below shows the results of the January 1, 2025 actuarial valuation including the final 2026 Minimum Municipal Obligation (MMO) (as the baseline). We have included the results (including estimated 2026 MMO) based on the two proposed DROP scenarios described above.

Because there is no prior plan experience as to when employees are expected to participate in the DROP, we have shown the financial impact assuming the current retirement assumptions and assuming that 100% of employees participate in the DROP when first eligible to retire upon attainment of 20 years of service reflecting their purchased service to illustrate that the financial impact is dependent on employee behavior based on when they purchase service, when employees elect to participate in the DROP and when they will resign.

Shown in Millions (\$)	Table II Impact of Plan Change using January 1, 2025 Valuation Results		
	Baseline	Plan Change - DROP Study	
		Scenario #1 Current Retirement	Scenario #2* Elect DROP First Eligible
Actuarial Liability	\$ 268.4	\$ 277.1	\$ 292.5
Actuarial Value of Assets (AVA)	\$ 241.0	\$ 241.0	\$ 241.0
Unfunded Liability (UAL)	\$ 27.4	\$ 36.1	\$ 51.5
AVA Funded Ratio (%)	89.8%	87.0%	82.4%
Estimated W2 Payroll for 2026 MMO	\$ 23.9	\$ 23.6	\$ 18.2
Estimated 2026 MMO	\$ 9.5	\$ 10.6	\$ 12.3

*As the payroll gradually increases as participants resign and exit the DROP, then the estimated 2026 MMO will increase.

The UAL increases by approximately \$8.7 million and \$24.1 million when compared to the Baseline scenario while the estimated 2026 MMO increases by approximately \$1.1 million and \$2.8 million for Scenario #1 and Scenario #2, respectively.

In addition, for Scenario #2, because we assumed members will enter DROP immediately once eligible, the payroll will initially decrease by \$5.7 million as the DROP participants' pay is excluded in the determination of the City's normal cost for the MMO and will not be replaced by new hires until the DROP participants actually resign. Therefore, the MMO may gradually increase each year under Scenario #2 over five years as the DROP participants gradually resign and are replaced by new hires. Assuming the payroll reverts to baseline levels and participants continue to retire immediately upon attainment of 20 years, the MMO under Scenario # 2 will increase to about \$13.4 million. There will likely be a similar increase in payroll under Scenario #1, but the impact is minimal as the payroll increase would only be \$0.3 million to the baseline levels.

The cost impact above does not reflect the employee contributions to purchase service. Assuming all participants purchase all available service (i.e. military service, Act 49 service, and other service) up to five years per participant, then the employee contributions from purchased service may range from about \$2.0 million to \$3.0 million which will decrease the UAL directly by this amount and decrease the estimated 2026 MMO about \$0.3 million to \$0.4 million. The actual employee contributions are determined by the City and may vary materially.

In addition, for purposes of estimating the impact on the MMO, we have assumed that the increase in liability due to the DROP will be amortized as a level dollar over 11 years. If implemented, actual costs associated with the DROP will depend on the actual number of participants who enroll in DROP, the amount of service purchased by participants, and the underlying demographics of those participants. Differences due to actual experience that may arise as participants enter the DROP or exit the DROP will be considered as gains or losses, which is amortized over the average future service (i.e. 11 years) based on the January 1, 2025 actuarial valuation. While it may be possible to apply a 10-year amortization period for the first year of a DROP plan change based on the actual participants who enter the DROP in the first year, after that initial year subsequent gains and losses would be amortized over the average future years of service.

This analysis includes purchased service amounts provided by the City. Table III below summarizes the various service that can be purchased by participants after reflecting the cap under each category as used in this study.

Table III			
Eligible Purchased Service Amounts			
	Counts	Avg Service	
Military Service*	18	2.83	
Act 49 Service	51	3.66	
Other Service	3	3.14	
Total	72	3.43	

*Note that one member with one year of military service also has five years of Act 49 service.

Finally, this analysis is based on the actuarial valuation data as of January 1, 2025 provided by the City. Table VI below summarizes the participants in the Police Plan.

Table IV	
Police Participants as of January 1, 2025	
Number of Active Participants	211
Average Age	39.4
Average Credited Service*	11.1
Average Annual W-2 Pay	\$ 112,071

*Does not reflect the purchase of any service.

Data, Assumptions and Methodology

The cost of a DROP is very sensitive to the underlying assumptions used and the actual experience with respect to retirement patterns. Once a DROP is implemented, retirement rates for participants may change due to participants entering DROP at an earlier date than when they would have typically retired. Furthermore, assumptions are needed on the length that participants remain in the DROP and the number of participants choosing the DROP. For purposes of this analysis, we utilized the following assumptions:

- 100% of eligible participants will elect the DROP when first eligible in Scenario #2. For Scenario #1, we are assuming the current retirement assumptions will continue.
- Eligibility for DROP was determined based on the participant's service including all available purchased service, up to five years in total, per participant.
- Purchased service was based on the service available to be purchased by participants as provided by the City in Table III, but not greater than five years. The maximum amount of purchased service for each participant was assumed to be immediately purchased to reflect possible participant behavior and the potential cost to the Plan.
- The employee contributions associated with purchasing service are provided as a range from about \$2.0 million to \$3.0 million in this cost study. If the City would like to provide the estimated cost that participants will pay, then we can update our analysis accordingly. To estimate the range of employee contributions, the following assumptions were made:
 - Military service: The employee purchase price for military service was estimated assuming that military service was attained immediately prior to the participant's date of hire in the Plan. Military service cost for each year was based on the "Annual Total Amount" of contributions made to the Plan associated with the year of military service purchase. This data was provided by the City in the document "Police Prior Active Military cost sheets" on November 21, 2025. Interest was not added to the employee military purchase price.
 - Act 49 service: The employee purchase price for Act 49 service was estimated based on the terms of Act 49 under Senate Bill No 464, as described below:

- (1) Multiplying the Plan's normal cost rate, not to exceed 10%, by the participant's average annual rate of compensation over the first three years of service with the police department; and
 - (2) Multiplying the product from paragraph (1) by the number of years and fractional part of a year of creditable prior police service being purchased together with interest at the rate of 4.75% compounded annually from the date of initial entry into full-time service with the police department to the date of payment.
- Data for the amount of Act 49 service available per participant was provided by the City and the survey data provided by the police administration to determine who was interested in purchasing Act 49 service. Please refer to Cheiron's November 4, 2024 cost study for more information on this study including the assumptions used to determine the employee purchase price.
 - Under Act 49, participants are eligible to purchase this service upon becoming vested (12 years of service). For this study, we assumed all participants immediately purchase the maximum amount of service under Act 49 to reflect the eventual cost to the Plan. For the 51 participants with the potential to purchase Act 49 service, 17 are vested as of December 1, 2025 and 7 more participants will be vested within two years. On average, the 34 non-vested participants with Act 49 service will be vested in about 6 years.
- Other service with the City: The employee purchase price for the three participants with "other service with the City" was based on data provided by the City on November 21, 2025. Other service cost for each year was based on the "Annual Salary Share" of contributions made to the Plan associated with the year of other service purchase. This data was provided by the City in the document "Police Prior Active Military cost sheets" on November 21, 2025. Interest was not added to the employee "other service" purchase price.
 - This cost study does not reflect the potential "cheapest" service purchase price associated with each participant nor does it analyze by participant whether or not purchasing service is a financially sound decision to increase the participant's pension benefit. It is our understanding that in practice a participant purchasing service will have the option to select which years of service to purchase and the type of service to purchase (i.e. military, Act 49 and/or other service with the City) to be most economically advantageous to the participant.
- Participants were assumed to stay in the DROP for five years.
 - DROP trust fund balances earn the maximum 4.5% interest per year.
 - The estimated 2026 W2 payroll from which the City makes contributions is assumed to decrease to reflect participants entering DROP immediately with the assumption that no new hires will replace participants who continue to work while in DROP.

In order to complete this cost estimate and as directed by the City, we determined the pension liabilities for the City of Allentown Police Pension Plan as of January 1, 2025 based upon the census data, assumptions, and plan provisions as of this date, except for the change in assumptions and proposed plan provisions outlined above. Refer to the January 1, 2025 Actuarial Valuation Report for the methods and assumptions, plan provisions, and other disclosures used in this analysis, except as otherwise noted.

The estimated 2026 MMO is based on the January 1, 2025 actuarial valuation results. We have estimated the impact of the change in the MMO for 2026 as if this plan change occurred as of January 1, 2025. If the DROP is implemented effective December 1, 2025, then it is our understanding that this plan change will be valued for Act 205 purposes as of January 1, 2027 for the 2028+ MMO.

Finally, the cost of the DROP will ultimately depend on the number of people who elect to participate in the DROP, the age, salary and service of those entering the DROP, and the number of years they stay in the DROP. We usually see changes in retirement patterns when a DROP is introduced. Our assumption that 100% elect the DROP at the earliest eligibility date and remain in the DROP for five years may be conservative, although actual participant behavior remains to be seen. To the extent that DROP and retirement patterns differ from what we have assumed in this analysis, these results will vary accordingly and maybe materially.

DROP Interest Crediting Rate Considerations

One of the DROP plan provisions is that the participant DROP accounts will earn interest. The interest rate for each DROP participants' account annually shall be the same as the overall investment return of the Market Value of Asset of the City's Police Pension Fund monies for the same year, subject to a floor of 0% and a cap of 4.5%.

This provision could result in a gain to the trust fund if the rate of return exceeds the cap of 4.5% assuming the DROP accounts remain invested similarly to the other Fund's assets. Alternatively, if the Fund has a negative rate of return during the year, then the Fund would absorb a loss on the floor of 0% interest provision. Furthermore, the Plan could face negative cash-flow risk if all DROP participants decide to withdraw their DROP accounts at the same time creating significant negative cashflows for the City which could reduce the City's ability to recover from a market downturn.

Alternatively, it may be possible that the DROP benefits could be transferred to a separate account held outside the pension trust. If the DROP accounts are invested in separate accounts that are not exposed to Plan's asset fluctuations, then there may be a gain or loss to the Plan due to the interest crediting rate on the DROP account compared to the Plan's rate of return. *We recommend that the City obtain advice from the investment consultant for the best methods to reduce the risk exposure of the assets under the DROP.*

Conclusion

The purpose of this letter is to present the estimated cost impact under Act 205 of providing a DROP to eligible participants of the City of Allentown Police Pension Plan. This letter does not address the impact that this proposed plan change may have under GASB 67 and 68 nor the possible residual impact on the OPEB plan as DROP participants resign from the City.

We rely on the City to provide new plan amendments, updated collective bargaining agreements, and/or accurate City ordinances reflecting pension plan changes and provisions. Because we are not attorneys, if this information is not available or Cheiron requires clarification of the plan provisions, we may request legal interpretation from the City's solicitor to provide such clarification.

The results of this analysis rely on future plan experience conforming to the underlying assumptions and methods outlined in this letter. To the extent that the actual plan experience deviates from the underlying assumptions and methods, or there are any changes in plan provisions, assumptions, or applicable laws, the results would vary accordingly.

This letter was prepared exclusively for the City of Allentown for the purposes described herein. Other users of this letter are not intended users as defined in the Actuarial Standards of Practice, and Cheiron assumes no duty or liability to such other users.

This letter and its contents have been prepared in accordance with generally recognized and accepted actuarial principles and practices and our understanding of the Code of Professional Conduct and applicable Actuarial Standards of Practice set out by the Actuarial Standards Board as well as applicable laws and regulations. Furthermore, as credentialed actuaries, we meet the Qualification Standards of the American Academy of Actuaries to render the opinion contained in this letter. This letter does not address any contractual or legal issues. We are not attorneys, and our firm does not provide any legal services or advice.

Please feel free to contact us should you have any questions.

Sincerely,
Cheiron



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cc: Jennifer Palenchar