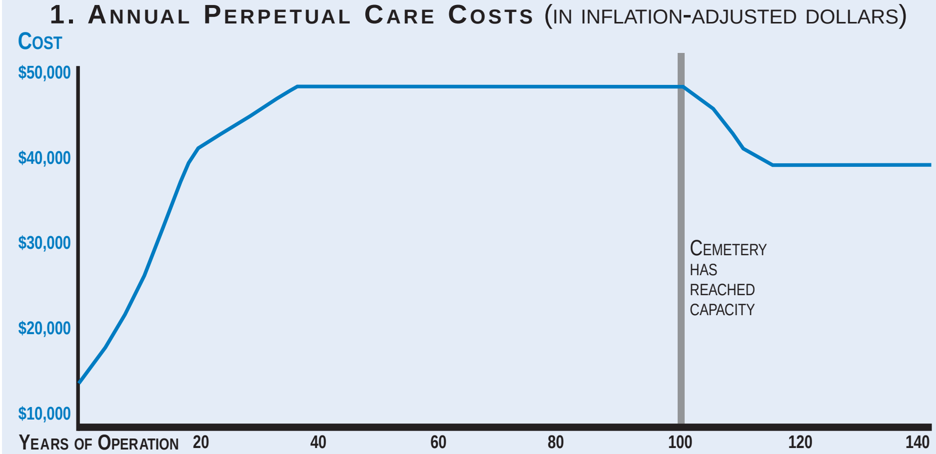
The Expenses Will Never End, But Some Revenue Sources Will

by Hayden Burrus

Editor's note: This is the second article in a three-part series about how to set up and maintain a perpetual care or endowed care fund for a cemetery.

1. Annual Perpetual Care Costs (in inflation-adjusted dollars)



The most difficult issue to deal with in setting up and maintaining an adequate perpetual care fund is the mismatch of perpetual care costs, cemetery revenues and perpetual care fund revenues.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First, let's look at **perpetual care costs**. They start out very low—cemetery grounds have not been developed, there is very little traffic on the grounds, and all cemetery property, landscaping and structures are new. Over time, costs increase for a variety of reasons, including inflation, increased cemetery usage (both in number of structures and number of visitors) and the aging of existing structures. During this phase, costs may increase significantly more rapidly than inflation.

At some point, cemetery use stabilizes and perpetual care maintenance requirements stabilize as well. During this period, increasing cemetery traffic forces costs to rise at a rate slightly higher than inflation. These factors lead to perpetual care costs doubling every decade or two.

As a cemetery reaches buildout and beyond, the number of visitors to the cemetery slowly declines. This decrease in traffic may slightly lower perpetual care needs. During this time, costs increase at a marginally lower rate than inflation. Finally, sometime after cemetery buildout, perpetual care requirements stabilize again. From this point forward costs will rise at the rate of inflation. Graphs 1 and 2 show how cemetery costs may develop over time, both before and after considering the effects of inflation.

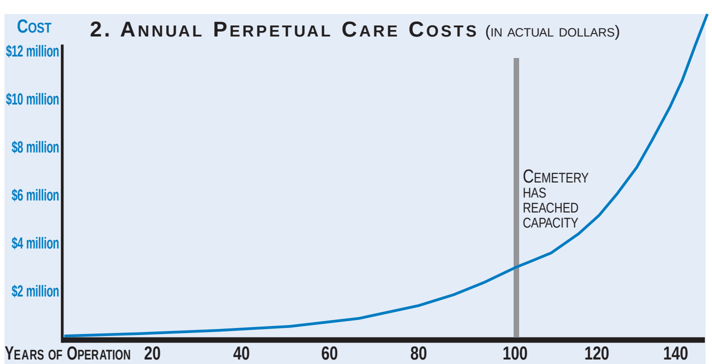
Next, let's look at **cemetery revenues**. Revenues start out at zero or even less than zero, if startup costs are significant. Very soon after a cemetery begins operating, cemetery sales begin, and revenues rise to a value far in excess of costs.

Soon, cemetery sales reach a steady state. On this side of the balance sheet, inflation is the cemetery's friend. Inflation allows cemetery pricing and revenues to continue rising until the cemetery approa ches buildout. During most of this period, rising revenues keep pace with rising costs

Finally, at buildout, cemetery revenues approach zero very rapidly. Costs, of course, continue to rise forever. A graph of the long-term revenue trends for a cemetery may look as charted in Graph 3.

Graph 4 highlights the difference between perpetual care cost and revenue patterns. Obviously, during the early phases of a cemetery's life cycle, the income statement can look very good. However, if the cemetery does not set aside enough money for the latter stages of its life cycle, the condition of the income statement can change very rapidly. It is in the cemetery's best interest to do this planning early, both to stabilize its income statement and fulfill its social obligation of ensuring that its grounds will be maintained in perpetuity.

2. Annual Perpetual Care Costs (in actual dollars)



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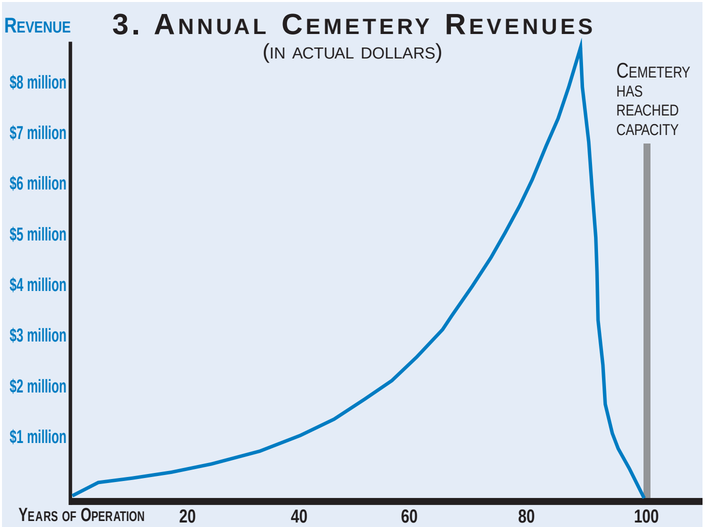

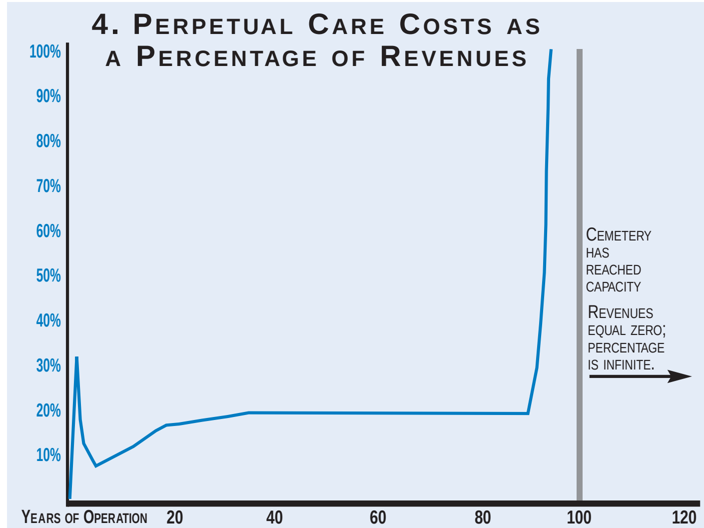

Graph 4 does not tell the full story. Investment returns are never known in advance, and returns will vary from year to year. This is a significant issue for investment income as well as capital gains.

Over the past 20 years, annual bond returns ranged from -0.7 percent to 23.6 percent (source: Lehman 1-5 year government/corporate bond index, 1978-1999). During the same period, stocks have experienced even more variability, ranging from -6.2 percent to 36.4 percent (source: Wilshire 5000 Total Market Index, 1978-1999).

Since only a portion of the investment returns of a perpetual care endowment fund is available to pay for cemetery costs, the variability in investment return directly results in an extremely uncertain and variable available cash flow to cover the rising costs of perpetual care.

A Few Examples

Next, I will move on to discuss specific perpetual care fund issues related to three hypothetical cemeteries:

- Millennium Cemetery: A new cemetery established on January 1, 2000.

- Active Cemetery: A cemetery very far away from buildout and with an active and successful sales force able to increase revenues each year.

- Historic Cemetery: An older cemetery needing restoration improvements and less than 10 years from buildout.

MILLENNIUM CEMETERY

Millennium Cemetery is in the best position to adequately fund perpetual care. Its brightest years in terms of revenue collection are still in the future. Specific endowment care fund issues for Millennium Cemetery are:

- **Revenues and costs are more uncertain.** Millennium Cemetery does not have a historic accounting record on which to base revenue, cost and sales projections. These projections must come from educated estimates made by cemetery managers. To compensate for the significant uncertainty in these projections, an actuarial analysis of this cemetery should use conservative estimates (low values for revenues and sales growth, high values for costs). Also, actuarial projections should be revisited more frequently and updated as specific Millennium Cemetery information becomes available.

- **Initial perpetual care costs will be higher than revenue from the fund.** Even a vacant cemetery requires some perpetual care maintenance. During the early portion of a cemetery's life cycle, a cemetery has very little money in its perpetual care fund to cover its fixed endowment care costs. If the funding of the perpetual care fund could be run as a business, it would be best for the fund to borrow money to help pay for its perpetual care costs during the earliest phase of the cemetery's lifespan. Since this cannot be done, Millennium Cemetery can expect to pay for some perpetual care costs from its general operating funds during this time.

- **After sales activity begins, perpetual care contributions may seem excessive**. One or two years after Millennium Cemetery begins operations, the money going into the perpetual care fund may seem too high because perpetual care costs are probably significantly less than the revenues generated by cemetery sales. The perpetual care fund is growing rapidly as the total number of plots sold doubles and re-doubles. This is to be expected. The perpetual care fund contributions being made today must grow inside the fund to help pay for perpetual care costs after the cemetery is filled.

ACTIVE CEMETERY

Depending on its history of perpetual care fund planning and follow-through, Active Cemetery's perpetual care fund may be in excellent financial condition at this point. Through analysis of a long history of accounting and financial statements, Active Cemetery has the greatest ability to accurately project its future cash flow. It also has the greatest ability to influence the future solvency of its perpetual care fund. Specific endowment care fund issues for Active Cemetery are:

- **The cemetery needs to have adequate funds available for perpetual care if the cemetery were to close immediately.** This concern is not an academic one for cemeteries that will continue operations until buildout. If adequate funds are not currently available for perpetual care, future perpetual care contributions must subsidize the perpetual care for past cemetery sales. This situation should be remedied as soon as possible.

A common cause of under-funded perpetual care funds for many of today's active cemeteries is that they did not start setting aside assets for perpetual care until the cemetery had been operating for many years. In these cases, current contribution rates may be "fair," but they may not be enough to produce the income needed to cover all of the cemetery's perpetual care costs.

Other causes of inadequate—or excessive—funds available for perpetual care include: incorrect contribution rates, unexpectedly high or low investment return, unexpectedly high or low cemetery sales and unexpected perpetual care costs. Two ways to address over- or under-funding are making a one-time deposit (or withdrawal) to the cemetery perpetual care fund, and adjusting future contribution rates.

• **Current funding rates must be correct.** Active Cemetery should periodically examine its financial condition in order to ensure it is on course to have enough perpetual care funds when it reaches buildout. Funding rates should be adjusted immediately whenever projected funds at buildout are believed to be inadequate.

• **Current balance of perpetual care fund may seem excessive.** Active Cemetery has seen its perpetual care fund balance increase rapidly for many years. Its sales are strong and are increasing every year. Maintenance is routine, and its costs are low relative to sales. There may be concern from consumer groups, the cemetery's board of directors or even the IRS that the current perpetual care fund balance is excessive.

But this fund must last forever; though it appears excessive, it may not be. The best way to address such concerns is through information. A detailed actuarial analysis projecting perpetual care fund cash flows coming from contributions, revenues, investment return and withdrawals is the best way to show others a true picture of the condition of the perpetual care fund.

HISTORIC CEMETERY

The managers of Historic Cemetery are probably now actively planning for the end of the cemetery's time as a revenue generator. Of course, this will not eliminate its obligations to maintain the cemetery. Soon, perpetual care funds will not be supported by sales, but this should not be a problem if Historic Cemetery has planned and actively encouraged the growth of its perpetual care fund. Specific perpetual care fund issues for Historic Cemetery are:

• **The cemetery should have adequate funds available for perpetual care if the cemetery were to close immediately**. This is now an immediate and pressing concern. In a few years, it will no longer be able to subsidize perpetual care costs with sales, nor will it be able to feed its endowment care fund. Soon the only endowment care fund activity will be investment return gains and perpetual care costs. Even at this point, investment return should always be ahead of costs. Each year, perpetual care costs will continue to rise due to inflation. Each year, therefore, investment return must also rise. The only way to do this is through retained investment returns.

• **Funding inadequacies (or surpluses) must be addressed.** Historic Cemetery may perform an actuarial analysis on the endowment care fund's balance sheet and find that current funding levels are far different from the amount required to support its perpetual care. Whether the fund is too large or too small, the cemetery should act sooner rather than later.

If funds are inadequate, Historic Cemetery should make a one-time contribution from general operating funds to cover the shortfall. If the shortfall is ignored, perpetual care costs will eventually rise above investment return, the perpetual care fund balance will decline, the cost shortfall will be aggravated, and eventually Historic Cemetery's perpetual care fund will be exhausted. An immediate, one-time contribution can prevent that from happening. Fund surpluses should be addressed rapidly as well, before they become too large.

• **The cemetery should adjust perpetual care fund investments to ensure that available withdrawals will exceed perpetual care costs**. Currently most state regulators do not permit cemeterians to withdraw capital gain income from perpetual care funds. Due to this limitation, it would be prudent for Historic Cemetery's managers to meet with an actuary and possibly a financial planner to determine the appropriate mix of investments that will assure adequate available cash flow for perpetual care costs.

Coming next issue: Developing a perpetual care fund financial plan.

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