

ICCFA Article  
Summer

## **Guaranteed To Fail!** **By Daniel M. Isard**

By my estimate more than 90 percent of all cemeteries, not owned by a municipality, are going to fail. This is not hyperbole, it is simple math. Allow me to explain my math, the conclusion, and the solution, before it is too late.

Historically, cemeteries have gravitated from the responsibility of the city or a religious entity to being solid operating businesses. As little as 50 years ago, cemeteries were not seen as businesses. Those few that were, were held up to public ridicule or jokes. Today, many cemeteries are professionally run and managed businesses and career managers are seen as professionals and not glorified grave diggers. The industry has gained a professional credit status with lenders and has numerous professional representatives overseeing legislation at the state and national level, including ICCFA's staff of professionals and volunteers. It is time for us to recognize the industry's greatest secret, fix it, and not be embarrassed by it in the future.

In my opinion the industry's greatest secret is the underfunding of the perpetual care/endowment care funds ("PC Funds"). Before you get too self righteous and proclaim in that little voice in your head, "My PC fund is properly funded", understand what I mean by "underfunded". You might be properly funded for state law application, but that regulatory compliance does not prove your PC Trusts are properly funded. Allow me to introduce the mathematics of my contention.

There are two lifetimes of a cemetery; the active Interment Lifetime and the Dormancy Period. During the Interment Lifetime you are developing the property, selling the interment rights, and marketing the property at need and advance need. Of course, you are also maintaining it during this period, mowing, repairing, insuring, and helping people find graves of loved ones. Just as there is a cost of the marketing and selling of these interment options, there is a cost of maintenance. During the Dormancy Period, the cemetery is fully subscribed and someone is maintaining that property in perpetuity.

I do not want to belittle the IQ of the reader but I must point out the common use of the word "perpetual" in the PC fund and the period of time for the maintenance of the cemetery during the Dormancy Period. It is not a coincidence. It is most intentional. Perpetual is defined as, "that which is

everlasting and continuous; without a limitation as to its time span; eternal as opposed to having a finite period". Your PC Trust must be prepared to provide for the care and maintenance in perpetuity. When it ceases to provide for these expenses your cemetery is going to bankrupt and it will then have failed.

As you sell interment rights you have state mandated laws that prescribe how much should be deposited into a PC Trust. The state laws vary in amount and computation. In some cases the mandated amount is going to be a percentage of the sale price (10 percent or 20 percent) and in some cases this might be a flat dollar amount based upon the grave size (\$10/square foot). In either case this dollar amount gets deposited into a trust which is intended to provide sufficient earnings so that when the cemetery is fully subscribed, the caretaker/manager will have sufficient interest earnings to generate an annual amount large enough to cover the cost of the annual maintenance costs.

Who came up with these computations? Why are all states not the same? How do you test for the adequacy of the objective? Frankly, I think, the state doesn't want to know if their regulations will result in the proper conclusion and just as frankly, I don't think this industry wants to comprehend this problem. If I am right, it could mean that 90 percent of all cemeteries would have an unfunded liability on their books. That is not going to make your lenders happy, and it is going to wreak havoc with your personal balance sheets. Of course, I can concede this point because I am right, unfortunately.

In more than 500 valuations, I have seen only one profit oriented cemetery that has set aside more money than is required by the state PC Trust mandate. I know there are more than 8,000 profit oriented cemeteries and I have seen about 6.5 percent of the total. It might be that the other 7,500 are over funded. With that being said, let us agree that it is rare that a cemetery mandate the funding of an amount greater than the state regulation.

If you are attempting to purchase a cemetery, and that cemetery has less than 30 years of inventory, you must look at the perpetual care trust amount. Do not focus on the compliance of the cemetery trust; focus on the survivability of that trust into the Dormancy Period. You might not be able to sell it when there are only a few years of inventory left. You might wind up holding onto it into the advent of this Dormancy Period. If that is the case, you better be a good manager of overhead expenses because at that point in time the amount of principal in the PC Trust is never going to be greater than it is on the first day of the dormancy period.

We have several public companies owning cemeteries as part of their business plan. Why are they not aware of this? I think they are, and either do not want to recognize it, or they have plans to continue to extend the inventory so that their properties will not be full during their corporate tenures. However, the thought is that public companies are going to operate into perpetuity. So, they should address for their shareholders how they can manage properties when the property is fully subscribed and the trust doesn't produce enough interest to cover the costs of maintenance.

In most states, during the Interment Lifetime the manager can use the interest earning to reimburse themselves for their cost of property maintenance. During the Interment Lifetime the PC Trust spins off enough money to placate the property owner/manager to perceive that all is well. When a cemetery is sold, the new owner compares the PC Trust balances to the PC Trust filings and computes that the trust is adequate; however adequacy is defined as compliant with state regulations. My conclusion is that this adequacy is not going to be sufficient in the long term.

Most PC Trusts are written to provide for the interest earnings to be available to the cemetery operator for their maintenance costs. In most states the principal of the PC Trust is off limits. The makers of these rules understood that the invasion of principal, if allowed, would cause these trusts to fail and didn't want that to be allowed to happen.

So, what is the proper mathematical equation? This is a three step computation;

Question 1, in your business today, what is the dollar amount that it takes to fully maintain your property. Add all staffing costs including the cost of the property servicing staff, someone to answer the phone or take consumer questions and someone to oversee all operations. This staffing cost must be marked up to cover payroll and income taxes and all common benefits. You must also assume the property will continue to be subject to its insurance costs as well as equipment to maintain the property and all expenses for routine maintenance. Since this is an annual computation add something for the annual allocation for long term capital improvements such as water lines, utilities and fencing which need to be replaced routinely. Utilities are a big variable as some cemeteries don't water, some water from their own wells and some use water from the local water utility provider. Lastly, add a small amount for miscellaneous annual expenses including filing the tax returns and other compliance annual reports.

Question 2, if you had to assume an interest rate that your money would earn, year in and year out, what interest rate would you assume? The interest rate would have to be conservative and have no risk of principal.

Question 3, what is the resulting amount of money you must have in the trust now, to provide for that today? How will Question 1's answer change when the property is fully subscribed? Will you need more maintenance people and costs? What will change? How much would that cost be? The interest expense will not change, how much will you need the day the property becomes fully subscribed?

For example, look at Long Rest Cemetery in Maintown. This is a 40 acre cemetery with nothing but graves. When they are fully subscribed they will have 32,000 interments over an 80 year period. Long Rest's management perceives it would take three people year round to fully maintain the property, one secretary and one property manager. The combined costs are going to be in today's dollars about \$240,000 in payroll. That is going to be grossed up for taxes and benefits by 35%, which is about \$85,000, so their total salary, benefits and taxes are estimated in today's dollars to be about \$325,000. Insurance is about \$15,000 and routine maintenance costs are about \$25,000. Water and electric to the property is about \$60,000. They estimate that if they set aside about \$5,000 a year that would cover the estimated long term capital replacement costs and another \$10,000 for miscellaneous items. When all is computed, in today's dollars Long Rest needs about \$440,000 a year.

If they are being conservative, Long Rest assumes that they could get a 2% return on conservative investments, on average, year in and year out. How much money do you need to have in a trust, assuming a 2% interest earnings, sufficient to generate \$440,000 of interest earnings? That would take \$22,000,000 to be in trust, in today's dollars.

On a per grave basis, that would require a deposit of \$687.50 per grave as a contribution into the PC Trust. That is high now, but it was probably 400% the price that the graves sold for 80 years ago!

Furthermore, this amount is the present value. Maintenance is not just for the first year, it is for every year in perpetuity. The staff costs, benefit costs and tax costs are going to rise each year. It is going to cost more for insurance premiums and other costs. In fact, if you were to look at the present value of this overhead rising at only 2% per year for the next hundred years, this amount is going to be \$3,125,000 per year in overhead. In order to have enough money for principal and interest to amortize my operating costs for the next 100 years, I would need to have more than \$43,000,000 in trust when the property begins its dependency period. Of course, that is principal and interest and it runs out in 100 years. For me to have interest only coming out of the trust I would have to have interest only coming from the

trust that would require over \$58,000,000 to be in the PC Trust upon the beginning of the Dormancy Period, and I would have to factor in another cost, income taxes. During the years that the trust would have more earnings than expenses, there would be an income tax on the profit.

So, you can imagine if you cannot conceive of a cemetery where people over the last 80 years put aside \$687.50 per grave space, they are not going to put away almost three times that amount!

The reason this is not talked about is no one envisions operating their cemetery when it is fully subscribed. Someone is going to be the owner, and we are going to see hundreds of these self subscribing cemeteries facing this dilemma each year beginning in the next few years. As we recognize this problem, it is not inconsequential, especially in the growth of for profit cemeteries after the 1950's.

States don't want to talk about it. When a cemetery falls into disrepair and it has to be taken over by a state or municipality, it is major news. There are accusations from all sides. The reality is, there are two times a government winds up taking over a cemetery; when there is theft by the operator and when there is not theft by the operator. Theft makes the front pages, but anyone who can do the math can conceive that there are going to be a large number of cemeteries, properly operated, properly trusted, properly regulated by the government overseers, that will wind up with inadequate interest earnings to provide for the cemetery's care.

Governments do not do a good job of operating a cemetery in the dormancy period. Some might even say that some governments don't operate cemeteries well during the Interment Period, as they lack creativity and the panache of an operator looking to create a location with an identity. However, the government is the failsafe to this industry, just as we are seeing it is the failsafe to banks. The umbrage the press is sensing from our population for the government bailout of banks is going to be modest compared to the mass hysteria as governments object to being the caretaker in perpetuity for thousands of cemeteries in the future. The good news is most of us will be dead; the bad news is don't be buried in your own cemetery as the population may not respect your final resting place.

Of course, I am only talking about the cemeteries operating for profit. I use that phrase so as to not confuse these cemeteries with non-profit status of many properties. To further complicate the mix, how many cemeteries are exempt from the perpetual care funding requirements of their state due to their being owned by a religious institution. These laws were passed when we envisioned "church yard cemeteries" being the domain and responsibility

for maintenance of the church. Today, we have seen former synagogues becoming churches, former Catholic Churches becoming protestant properties and even churches becoming pizza restaurants. What happens if one of these properties had a cemetery adjacent to it and that church ceased to exist?

Do we mandate that church cemeteries create perpetual care trusts now, due to their portability? That would be a fun bit of legislation to get passed! Do we get consumer that purchased interment rights in church cemeteries to sign a statement that they are aware of not having perpetual care of this cemetery? If you want to promote that legislation, then get ready to start with the recognition of the aforementioned cemeteries that are going to run out of money during the dormancy period to give that disclosure.

I think we need to realize that the saving grace to the cemetery business is the welfare system. We know that if the cemetery fails to have enough funds to maintain itself, it will become a ward of the state. Therefore, we are relying upon the government to take over your business, your once proud business. Or, in the alternative, let us truly fund perpetual care trusts in an amount that is sufficient for the real world, not just to be in compliance with state law.

How this money is invested is also a potential problem. This year we have learned that government backed mortgages can lose principal value as much as any corporate bond. When a corporate bond that was investment rated suffers its rating due to the downturn of its corporate rating, it is called a "Fallen Angel". We don't want to label it as a junk bond that got junkier. So we give this label implying it once wore a good rating, but now it doesn't. Investing for a perpetual care trust is not easy. If you look for higher interest, you might also get more principal value changes than you bargained for. I am not writing about investment options in this article, only that the investment you choose during the Interment Lifetime will impact the future of your PC Trust. If you make an assumption, make certain it is one that you can live with, as if you were personally underwriting the investment.

I hope that I am wrong. I hope that years from now you can all mock me. Maybe ICCFA can have a dunk tank as a fund raiser, and my penance for worrying you will be my time in the chair as you sling insults and balls to prove me all wet. However, math is my shepherd. It protects me. It leadest me to my conclusions. And as I prepare a computer table in the presence of my colleagues, it shelters me. Only time will tell.

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