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Preparing for the Future. Do You Have Enough Money in Your Care Fund?

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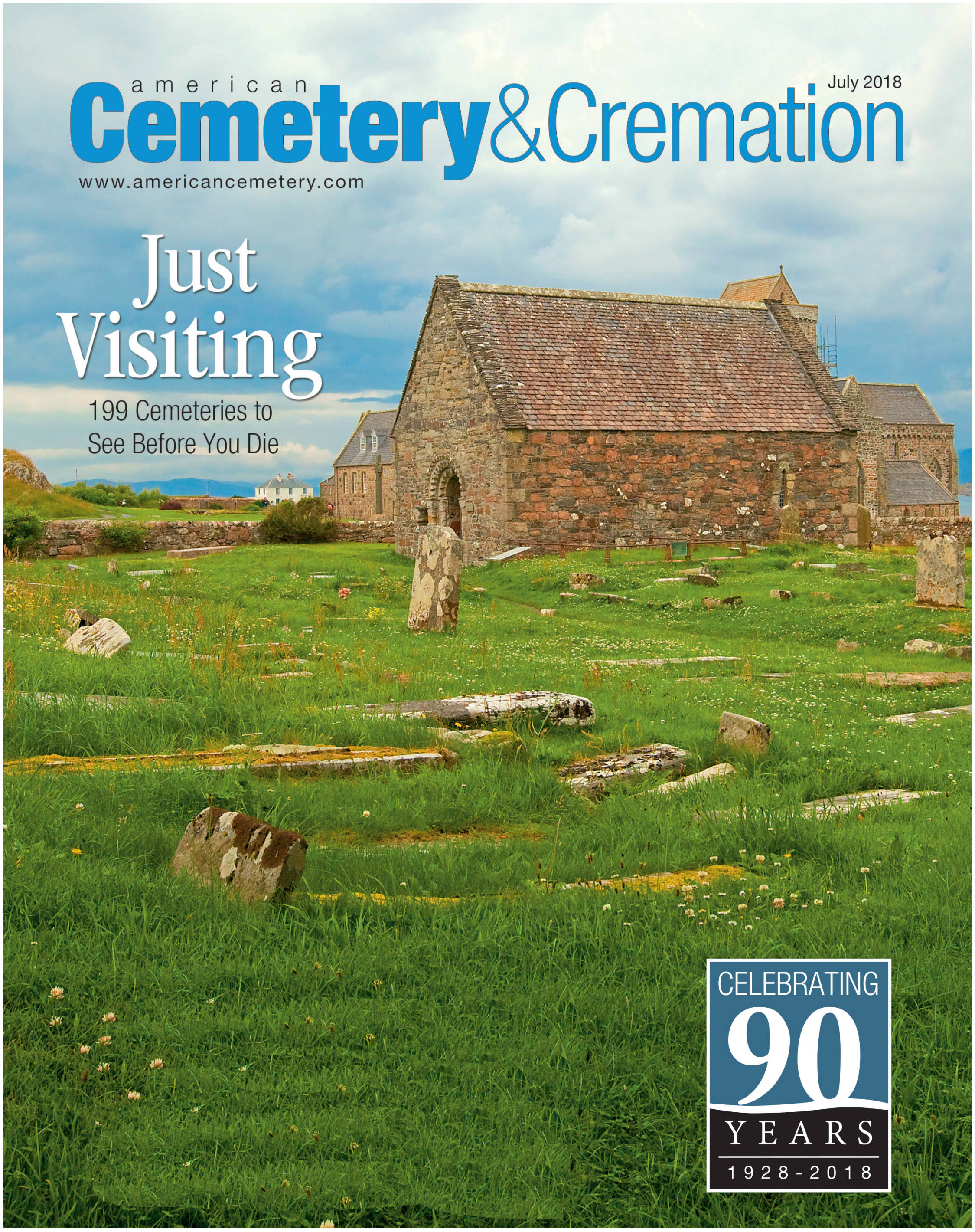

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Finance

By Todd D. Mannix

Preparing for the Future

Do you have enough money in your care fund?

This is a question we run into a lot in our travels across the country. Sometimes we ask the question of cemetery operators, but more often than not, the question comes from cemetery operators themselves.

This is particularly alarming, as the entire purpose of these funds is to allow the cemetery to maintain itself over time, and especially after the cemetery is full and there is no more income from current operations to support the cemetery's ongoing maintenance burdens. Government guidelines created the requirements around contributions to a care fund and the restriction on accessing the principal (amount deposited plus appreciation or growth) in order to prevent cemeteries from becoming an unsightly mess in the center of town (where many older cemeteries existed). The intent was to create a pile of cash that would generate interest and dividends through investments that would cover the maintenance costs of the cemetery at some point in the future.

Sounds like a good idea founded in good financial prudence. The problem is, while states require money to be set aside, usually as a percentage of sales, they do not create a framework for cemeteries to understand how much is actually needed and/or how it should be invested to accomplish financial self-reliance goals in the future. As a result, cemeterians across the country have these funds sitting there and do not know if it will really be enough or if they are doing the right thing with the investments to ensure the cemetery remains a beautiful place for loved ones to visit long after the land is full.

Some cemeteries take money out because they can, but still have revenue from operations that could cover these costs. Certainly, there is a tradeoff with income from operations (not care-fund income) as to what the current cemetery operator can take home as profit and how much income they take from the care fund to cover current maintenance expenses.

On the surface, it is hard for someone to take the long-term approach when there is no measure of what the financial goals are of the care fund. Let's say, for example, all else being equal, a cemetery had $4,000 of revenue after all bills and expenses that a cemetery operator could take as salary in a given month. In that same month, the care fund earned $500 and created the possibility of contributing toward maintenance. The cemetery operator

Model 1: Cemetery Withdraws Care Fund Income for Maintenance										
	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Year 7**	**Year 8**	**Year 9**	**Year 10**
Beginning Balance	$300,000	$312,000	$324,480	$337,459	$350,958	$364,996	$379,596	$394,780	$410,571	$426,994
Growth	$12,000	$12,480	$12,979	$13,498	$14,038	$14,600	$15,184	$15,791	$16,423	$17,080
Income	$6,000	$6,240	$6,490	$6,749	$7,019	$7,300	$7,592	$7,896	$8,211	$8,540
Withdrawals	($6,000)	($6,240)	($6,490)	($6,749)	($7,019)	($7,300)	($7,592)	($7,896)	($8,211)	($8,540)
Ending Balance	**$312,000**	**$324,480**	**$337,459**	**$350,958**	**$364,996**	**$379,596**	**$394,780**	**$410,571**	**$426,994**	**$444,073**

could subsidize the maintenance expenses with the $500 of income from the care fund. Nobody would fault the operator for doing so, as this is what the law allows. In this simple example, the cemetery operator might then be able to take home $4,500 in salary versus the $4,000 when the cemetery used 100 percent of the proceeds from current sales and operations to pay the maintenance costs. Not only would nobody blame the cemetery operator, but who wouldn't want an additional $500 of take-home pay at the end of a month? The problem in this example is in the term "all else being equal." This assumes we are making the decision in a vacuum and the decision to take money from the care fund does not impact future growth or income in the care fund.

However, when looking at the long-term health of the cemetery, taking the $500 from maintenance can be detrimental to the care fund's long-term growth.

The model *(above)* shows the example of the cemeterian taking the income each month. The model assumes a total of 6 percent total return (4 percent growth that cannot be touched, and 2 percent income that is allowed to be withdrawn for cemetery maintenance). For example purposes, there are no additions to the care fund from current sales, which would highlight further the impact of taking the income out of the earnings of the care fund.

In this model, the care fund principal is the only balance available to grow, as income is being withdrawn. At the end of 10 years, the care fund will have grown $144,073.29 at 4 percent growth. Some may look at this and think that without adding to the principal from contributions from sales, a total growth of 48 percent over 10 years is doing pretty well, and they would not be wrong. A 4 percent growth return is conservative, but one can see the benefits of investing for growth. In addition, the cemetery operator has been able to take money for maintenance every year growing from $6,000 in year 1 to $8,539.87 in year 10.

Now let's look at the impact of the care fund if the cemeterian were to pay for maintenance out of current operating proceeds and not taking the income from the care fund balance.

In this model *(below)* the care fund benefits from the total investment return of 6 percent (4 percent growth and 2 percent income) as the income is not being withdrawn. Notice that the same initial investment of $300,000 has now grown $237,254.31 over the 10-year period for a total growth of 79 percent. Not only did the care fund almost double, but if the cemeterian needed to take income in year 10 in this model, they would have over $10,000, rather than the $8,500 that was available in year 10 in the previous model.

Model 2: Cemetery Does Not Withdraw Care Fund Income for Maintenance										
	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**Year 6**	**Year 7**	**Year 8**	**Year 9**	**Year 10**
Beginning Balance	$300,000	$318,000	$337,080	$357,305	$378,743	$401,468	$425,556	$451,089	$478,154	$506,844
Growth	$12,000	$12,720	$13,483	$14,292	$15,150	$16,059	$17,022	$18,044	$19,126	$20,274
Income	$6,000	$6,360	$6,742	$7,146	$7,575	$8,029	$8,511	$9,022	$9,563	$10,137
Withdrawals	$0	$0	$0	$0	$0	$0	$0	$0	$0	$0
Ending Balance	**$318,000**	**$337,080**	**$357,305**	**$378,743**	**$401,468**	**$425,556**	**$451,089**	**$478,154**	**$506,844**	**$537,254**

The message here is not that cemeteries should not take income from the care fund. Cemeteries have that right by law and can utilize the proceeds for the upkeep and maintenance. Many cemeteries are in the position that income from operations (if any) do not cover the full maintenance costs and therefore they have to take money from the care fund just to keep their cemetery running. However, in the example above where the cemeterian has a choice as to whether to take the funds, but doesn't necessarily need to, how does he/she know if it is okay to do so? There is nothing wrong with a cemeterian taking a profit for their hard work and being paid for the good and in many cases tireless hours they put in for the good of their community. So how does a cemeterian make the right choice regarding when and when not to take care-fund income?

The answer is the cemeterian must first understand the long-term goals of both the cemetery and the care fund. Cemetery master plans outline the long-term development and goals of the cemetery and a care fund plan examines the expenses associated not only with current operations, but also future operations and the future development of projects highlighted in the master plan.

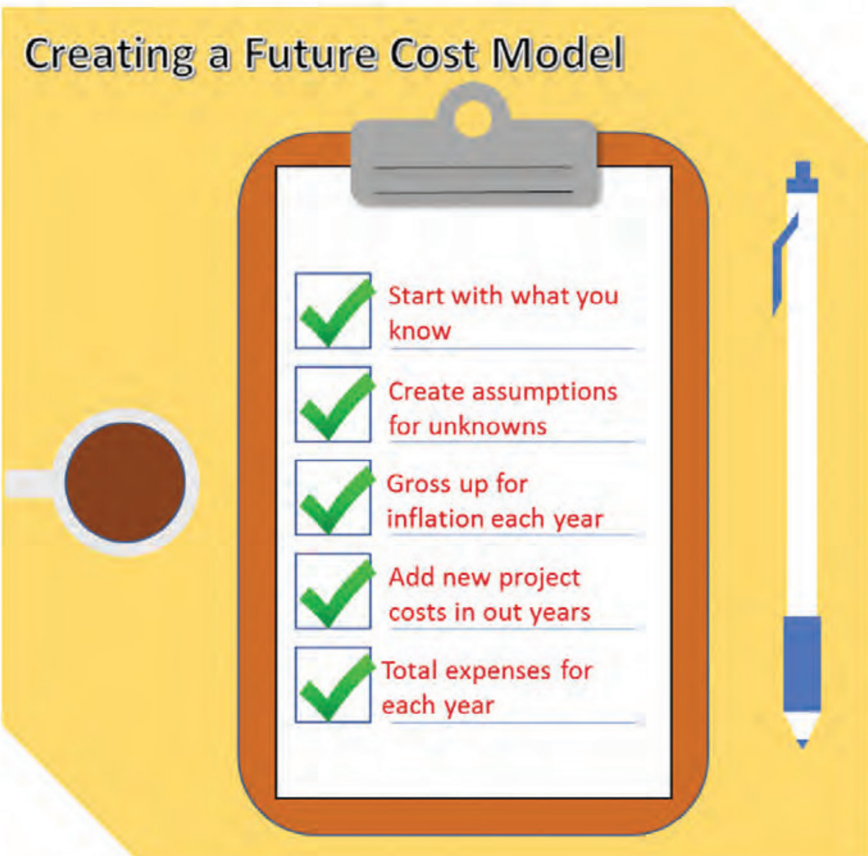
On the surface, trying to understand future costs can appear daunting, but some simple assumptions can assist cemeteries in understanding what their future needs may be. Once this is done, the cemetery can make reasonable assumptions as to whether taking income from the care fund today is or is not detrimental to the future needs of the cemetery.

Obviously, the more detail that can be used to create these calculations the better. Cemeteries should approach their accountants, consultants, or financial advisers to help them with the detailed analysis, but a cemeterian should be able to create a rudimentary model on their own to give them a basic understanding of the expense needs of the cemetery and then match those against the type of models on the previous page to determine the viability of the usage of income generated by the care fund.

1. To create the model, the easiest thing to do is to start with what you know. Use the current year's expenses to understand what a "normal" year would look like for current operations. Many cemeteries use an automated accounting package like Quickbooks or Peach Tree to do their accounting. A full year expense report should be easy to export and will give you as much detail as you need. Things to include are normal, everyday expenses that the cemetery will incur, year in and year out like utilities, gas, grass cutting and landscaping, snow removal (in the north), flowers, mulch, building repairs, etc. Is it safe to assume each year will be similar to this year or were there some anomalies that either added cost or reduced costs? If you want to be conservative, add as many costs as you can to make sure that the costs cover most of the "normal" expected expenses.

2. Next, think about the non-normal operating expenses that have come up over the years on a one-off basis. These things do not happen every year, but it is a possibility that they might occur every so often and should be somewhat predictable. Items in this category might be road repairs or paving, building maintenance, repointing stone walls. Make a list of these items, assign a cost at today's dollars, and make a guess as to how frequently they might occur. It is OK to guess. Especially in our industry, its understood that nobody can predict when things will happen in the future, but making educated assumptions based on your experience will help you to be realistic about what might happen and when.

3. Once you have the figures, lay them out on a spreadsheet and total each year. There are formulas you can use to do this for you, but to simplify it, take each cost in the previous year and multiply it by your inflation component, see chart next page. Two percent is a good assumption these days, but if you want to use a factor that is higher or lower than 2 percent, you may. Then add the increase to the previous year's total, and that will give you the inflation-adjusted cost for the next year. Continue this step for as many years as you would like to go



out. In the example on the previous page, the model goes out 10 years, which may be a good starting point.

To this point, you should now have an idea of your future cost of operations for as many years as you built out the model. This is a great starting point, and many cemeteries who do not have major projects can stop here and compare these future needs to the care fund and the assumptions on its growth over the same time period.

4. For those cemeteries that do have future projects in the years to come, estimate the cost in today's dollars and use the same type of inflation calculation to determine what the cost might be in the year you expect it to occur. Then add that cost to your expense model. Note that since the state mandates what a care fund can be used for, you only need to put in the corresponding costs that would be eligible to withdraw from the care fund income. Keep in mind that the development of a new section of the cemetery may

	Cost in Year 1	Inflation %	Increase ($)	Cost in Year 2
Electricity	$3,000	2%	$60	$3,060
Oil	$1,000	2%	$20	$1,020
Landscaping	$5,000	2%	$100	$5,100
Equipment Maintenance	$3,000	2%	$60	$3,060

not be entirely eligible (or perhaps the cemetery has funds earmarked for the construction of that project). Also, the increase in normal operating costs will need to be estimated as there will be more acreage to maintain.

5. Lastly, adding up all the costs for each year will provide a simplistic view of what the future expenses may be. This is meant to be a simple model to give a rough idea as to the expected costs of the cemetery. As mentioned previously, a professional can be consulted to apply more variables and create a "tighter" picture for you. Regardless of who you consult, if you decide to get more detailed, you will need to start by collecting the same data from the steps above so they can understand how your business runs.

Once the costs are complete, you can look at the revenue side of your business and decide if taking care funds when you do not actually need them is the right thing to do for the long-term health and well-being of the cemetery. If you are in a position where you need to use the care funds, you will be able to see and understand the impact on the fund accumulation on a long-term basis. Armed with this knowledge, you will be better prepared for the future. •