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How Long is Your Time Horizon on Your Care Fund?

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The following article was first published in the April 2019 issue of American Cemetery and Cremation magazine, and is reprinted with permission.

Finance

By Todd D. Mannix

How Long is the Time Horizon *for Your* Care Fund?

The questions most savvy investment advisers will ask when meeting a client for the first time include those pertaining to their future plans in addition to how much they currently have invested and their aversion to risk. The question pertaining to future use is typically posed as, "What is your time horizon?" Time horizon simply refers to the amount of time that you can keep the money invested before you intend to use it.

For example, a retirement fund would have a long horizon of decades, while planning for the purchase of a car may have a shorter three-year horizon. Regarding cemetery care funds, the time horizon is essentially in perpetuity.

By definition and according to most state laws, an endowment or perpetual care fund is there for the long term. The principal is invested and not to be touched. The interest and dividends from the underlying investments are considered income and, depending on state law, may be used for the ongoing maintenance of the cemetery.

The concept of a care fund is beneficial to the cemetery, the city or town where the cemetery is located, and of course for the people who reside there and visit their loved ones. The problem is that most states stop at dictating a minimum to be deposited into the care account from each plot sale. The assumption becomes, for those who inherited the business or who got into the business to take care of their community (volunteer or otherwise), that if the state mandates a certain amount to be placed in the care fund, that must be enough to take care of the cemetery in the future.

This common misconception is akin to the baby boomers who thought paying into Social Security alone would be enough to fund their retirement (or even that it would still be there when they needed it). A cemetery could have abided by the state guidelines from day one and still not have enough to keep up with increasing maintenance costs in its later years.

Most originating owners may not have considered that in order to create an account that would completely sustain the cemetery's maintenance (when it was fully matured and sold out years into the future), they would need to deposit a lot more than the state minimums. Today, there are cemeteries all over the country that are seriously underfunded with regard to the care fund, especially when considering the maintenance needs that exist for the property.

Some of these cemeteries have had misappropriation of funds through unscrupulous prior owners or through money disappearing through change of ownership situations. However, many have simply followed the law and found themselves behind the times in terms of the care fund generating enough revenue to take care of the cemetery. This puts a lot of stress on the cemeterian to ensure that the balance of the care fund continues to grow and adds more income for the cemetery maintenance.

We have seen many cemeteries create a second account (in addition to the mandated care account) that they treat like a care fund account, but that is not under the jurisdiction of the state regulations. In these circumstances, the owners had the foresight to understand the state minimums would not be enough. Rather than contribute more to the care fund where all of the money would be restricted, they gave themselves a little more flexibility by creating a separate, unregulated account and treating it the same as a care fund. In doing so, they are still 100 percent compliant with the state laws by contributing the minimum to the regulated care fund, but they also contribute what they can (either a set amount according to cemetery policy, or what they deem appropriate at the time) to the separate account.

They treat the separate account the same way as a care fund in that they do not touch the principal and only take from the income (dividends and interest) if needed. If, however, the cemetery comes across difficult times or wants to take on a capital-intensive growth or expansion initiative to generate more revenue opportunities, the principal in the second account is accessible as it is only the cemetery policy that restricts usage of these funds. What's interesting to note however, is that those cemeteries that were financially prudent to create this additional account or fund almost never touch the principal and instead just take the income if needed. Many cemeteries that only have the state-mandated care fund struggle to find ways to make ends meet when restricted to using the income from their current operations plus the income from the state-mandated care fund.

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Of course, there are a couple of downsides to keeping a separate account free of regulatory restrictions. The first is that if the state mandated minimums only are put into the regulated account and the market was to drop significantly during a reporting period, this could render the account as underfunded, due to no fault of the cemeterian. The state may then require the cemetery to make up the difference to make the care fund "whole." The laws we have seen around this action can be loose and vary by state, but nevertheless, it may cause some issues with state auditors. If the extra funds were added to the regulated care fund as opposed to having been deposited into this separate account, then the regulated fund would most likely have passed the required minimums, even in a down market. A secondary downside is that should the cemetery ownership be transferred in the future, the account is not regulated by law, thus the new owner could have different plans for the extra funds, rather than their intended cemetery care.

For those cemeteries that did not have the foresight (and do not worry if you didn't, those who have are in the minority) to put away more funds and are finding it difficult to maintain the cemetery with the care fund assets, you are not alone. Many cemeteries depend on the income from the care fund as their lifeblood. It is hard when this is the case to look at the fund when the market is down and resist the urge to make a change. You want to preserve the assets so they continue to generate income, but receiving a statement showing a decrease in principal can put a pit in your stomach.

Before making any changes, consider the long-term nature of the market and what your time horizon is. You may have specific projects you want to accomplish in your cemetery, but it shouldn't change the time horizon of the care fund, it's meant to be there in perpetuity … forever. What this simply means is that you can ride out the dips in the market with a little less trepidation than if it was your retirement account, which does have an end point where you intend to use the money put aside. I always tell people that a care fund is like a retirement plan for a person that never dies. With a retirement plan, most people shift the investments and the risk as they approach retirement age because they cannot afford to lose a portion of their nest egg as they move to a point in their lives where they will have less income. Retirees and soon-to-be retirees often move out of the stock market into more interest-producing investments that are less susceptible to the swings of the stock market. More simply put, they have a shorter time horizon. They want to ensure the money will be there for a fixed amount of time … as long as they live, so they get more conservative, the older they get.

With a care fund, not only is there no end point, but also it needs to continue to grow over time so that the income it generates tomorrow will continue to grow as the principal base grows. This means that a cemeterian has to keep the money in the market, and that can cause a lot of nervous days if you are fixated on the balance and the income as most cemeteries are. Here is the good news: The fact that your timeline is forever affords you the ability to ride out storms in the marketplace that many investors cannot.

Let's take a look at this using historical market data. If you had followed your care fund balances on a daily basis over the past several years, you would have seen several days with wild, close to 1,000 point swings in the Dow Jones Industrial Average (both up and down). The down days would have contributed to symptoms that might create an ulcer, and the up days might have filled you with hope that it might continue to trend that positively. If you followed your daily balances that closely with the daily volatility we have seen in the market since the recession, you might have developed a split personality. It's a long-term investment; so while it's important to keep on top of it, doing so daily when you are so dependent on the fund might just put you in the hospital.

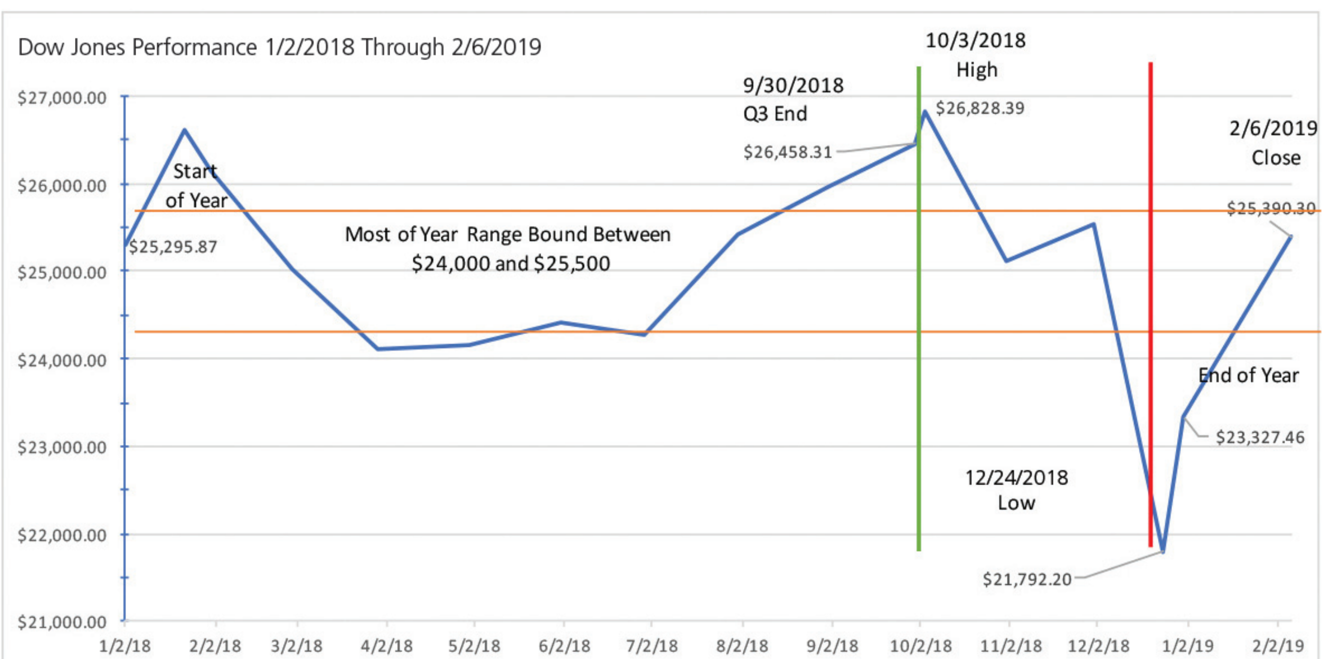
So, what is the right time horizon to evaluate how your care fund is doing? If you looked at the year-end return of Dec. 31, 2018, most funds would have seen a net loss for the year. The ending Dow performance numbers reflect it being a poor year for the market, although if you look at the data, it actually shows that while the market was down from Jan. 2, 2018, to Dec. 31, 2018, (-7.8 percent) the market was a bit more promising than that simple metric indicates.

If you look at the chart below, you will notice that for most of the year, the market pretty much stayed between $24,000 and $25,500 (range-bound).

The market rallied through the third quarter achieving a high of $26,828.39 on Oct. 3, 2018, (the beginning of the fourth quarter). At that point, the market was up 6.1 percent for the year..

Several factors put pressure on the market going into December and caused a drop to $21,792.20 on Dec. 24, 2018, a drop of (-18.8 percent) off the highs and a drop of (-13.9 percent) since the beginning of the year.

So, the fourth quarter was bad, causing the year to look bad. Remember, at the beginning of the fourth quarter, the market was up 6.1 percent. If a cemetery had forgotten its time horizon, got nervous, and sold out of its position in the market Dec. 24 or even Jan. 2, 2019, it would have missed what came next. The market



came back over the next month and a half. By Dec. 31, 2018, the Dow was back at $23,327.46 over $1,500 points off the low or a 7 percent increase from Dec. 24, 2018, bringing the loss for the year back to (-7.8 percent).

As we moved into 2019, the market continued to recover, and as of Feb. 6, 2019, the Dow was at $25,390.30, erasing all the losses from 2018 and up $94.43 or 0.4 percent from Jan. 2, 2018.

The 2018 year-end market results were a perfect example of why cemeteries need to keep their heads when it comes to their care fund investments. If a cemetery sold on the low of Dec. 24, 2018, even if it put the money back in Jan. 2, 2019, it would have missed half the gain after the dip.

So, if you look at it in terms of a day, unless you are a proven professional day trader (and most cemeterians are too focused on their businesses to do that), a cemeterian should not be concerned with daily ups and downs. This doesn't mean they shouldn't pay attention to what is going on, just that they should be consulting their investment professional and not being concerned with the very short-term day-to-day fluctuations.

What about if you look at the market in terms of a quarter or even a year? In the example above, both the fourth quarter of 2018 and the year of 2018 looked badly, when in actuality, it was a four-month correction that reversed itself.

The point of this article is not to give advice on the decisions a cemetery should make when it comes to its care fund. Nobody can do that unless they know the cemetery's individual situation. The purpose is only to make the point that a care fund is a long-term investment vehicle intended to generate current and future income for the cemetery. Cemeteries should consult their financial advisers or finance board and discuss the objectives of the fund in the long-term, but they shouldn't sweat the short-term fluctuations as they will come and go. There is no guarantee that past performance will be any indication of future results, but any long-term picture of the market's past shows that over time, it goes up. The only concern is if you have a short time horizon, which cemeteries do not. •

Disclaimer: This article is written as opinion and to demonstrate the long-term nature of a care fund investment. Other than specifics of past market data, there are no factual assessments or statements that should lead a cemetery to make any financial decisions. The article does not offer advice or an opinion of what any cemetery should or should not do with respect to their individual care fund. Only the cemeterian and/or their board will know what is right for their cemetery. A cemetery should consult a professional who can understand their unique position in order to provide direction.