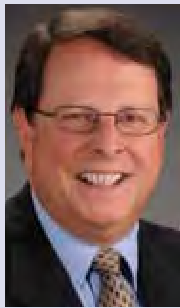
by Daniel M. Isard, MSFS



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ICCFA Magazine author spotlight

➤Isard is president of The Foresight Companies LLC, a Phoenix-based business and management consulting firm specializing in mergers and acquisitions, valuations, accounting, financing and customer surveys.

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More from this author

➤Educational information, including copies of this article, can be found at ***www.theforesightcompanies.com***

➤You can follow Isard on Twitter at *@f4sight,* LinkedIn and "like" The Foresight Companies on Facebook.

Editor's note

The Cemetery Impossible column is written by the staff of The Foresight Companies. **If you have a question you want to be featured in this column, please send it to danisard@f4sight.com.** Dan Isard or a member of his staff will call you to get more information and a recommendation will be provided via this column, helping not only you but also others who are facing similar challenges.

Even if your cemetery has always abided by your state's perpetual care regulations, you should not be complacent. When the day comes that there are no more sales to be made, you'll realize that there is no such thing as being overfunded.

Cemetery Impossible

Taking over a cemetery just before the sales run out calls for a hard look at the trust fund

Dear Cemetery Impossible,
I live in a small town and own the local funeral home. There is one cemetery in town. It is a 40-acre cemetery and down to its last salable acre.

The current owners have come to me and asked me to buy it. They are asking for $100,000. That doesn't seem like much. My banker thinks he can do a loan for me through the SBA.

My concern is, what happens when it is fully subscribed, which could be within 10 years? I have been told by the owners they are fully compliant with their perpetual care funding requirements.

Right Time To Buy

Dear Right Time,
I have done articles in the past on the issues involved in value, so I won't waste the column inches to repeat myself again.

But a purchase price of $100,000 doesn't mean that you can only lose $100,000! The bigger issue is the perpetual care (PC) involved with a cemetery. I don't want to sound alarmist, but after four decades of dealing with this, my concerns are well defined.

Perpetual or endowment care funds are a legal requirement established by a state for funding a principal amount into the trust. Each state has a law that dictates the amount which must be deposited into the PC trust each time there is a sale.

During the operation of the cemetery, this trust has earnings and those earnings are used to provide the owner with some income to maintain the physical plant and care of the cemetery.

It seems simple. However, over time, errors can happen.

There are three possible problems that

can occur:

1. Being underfunded
2. Suffering loss of principal
3. Being properly funded

1. Underfunding is a common concern. The PC fund receives deposits year after year. During the 100 years or more of the trust's lifetime, it is possible that some of the previous owners, or the current owner, didn't properly meet the required annual funding amount.

Imagine that during the depression an owner didn't fund the required amount. You can never know that now. Many cemeteries have had problem owners. Some cemeteries may have started out as owned by a PC-exempt organization such as a church, then later been sold.

If you buy such a cemetery today, you might find that though it's been properly funded by the sellers, while it was owned by an organization exempt from PC funding requirements, full PC funding did not occur.

2. Principal loss. Assume that each year the proper amount went into the trust. Assume the trust invested that money. What happens if that trust has investments that caused a loss of principal? This creates a problem for whomever owns the property when there are no more sales on which to rely.

Many people think that loss of principal can come about only due to theft. Not so. If you were invested in a conservative bond portfolio in 2007, at the end of 2008 you might have had a 20 percent to 30

Hire a qualified firm to compute what the maximum should be while you have time (i.e. before there are no more lots to sell). Be prepared to amend your perpetual care funding requirements to increase contributions to the trust for all future sales. Then, review the trust investments. It might be you need to invest for some growth in the portfolio (subject to state law).

percent reduction in principal value! If you subsequently sold the portfolio, you never recovered.

You didn't do anything illegal, but your trust took a hit. Had you held on and been patient, the markets came back in 2009 and 2010, but those who sold their bonds took a big hit.

Some trusts are used by people as their stock "play fund." They invest in many risky public common stocks and may have a lot of losses. Some states have "prudent man" requirements for investments, but not all have this protective clause.

3. Properly funded. You must be thinking, "What can be wrong with a trust that is properly funded?" Even if PC is funded each year, and the investments have not suffered/lost principal, you can be in a world of hurt if you are the owner at the end of the sales cycle.

State laws dictate what the PC funding requirement is for a cemetery. Some require a percentage of the interment right sale be deposited. Some states require a deposit calculated per square foot.

Frankly, both methods are compromises created by state regulators and have no basis in the reality of what is needed. It is the same problem we face with Social Security.

Assume you have a 40-acre cemetery and you have 1,000 graves per acre. That will ultimately result in 40,000 gravesites. You can establish that the PC contribution must be $100 per grave.

That means when this cemetery is fully subscribed, assuming no loss of principal and all interest distributed over the years to maintain the cemetery during the sales period, the trust will have $4 million.

That sounds like a lot of money, but is it enough to fund the care and maintenance of the cemetery from interest earnings alone, in perpetuity?

Let's say the cemetery needs to have water at the cost of $100,000 a year. Assume it takes a crew of three to maintain the property at a payroll expense of about $150,000 a year. This maintenance effort will require repairs and proactive maintenance of about $50,000 a year. Insurance, accounting and other costs need to be covered. When all is added up, the costs of maintenance each year in this hypothetical situation add up to $400,000.

If the PC trust is $4 million, will that be enough to fund this annual need? In reality, no.

Most state laws allow only the interest be used. In an 8 percent interest environment (yes, I am thinking about the 1990s), you would generate about $320,000 a year. That represents a shortfall.

However, for the past decade we have seen conservative savings account interest rates in the range of one percent. Even assuming a 5 percent blended rate generates only $200,000 a year. Again, a shortfall.

The problem is that the funding rates set by the states is not tied to the costs of maintenance, nor is it tied to a variable interest rate environment. What might be enough principal in a 10 percent interest rate environment is a significant shortfall at 5 percent.

The other concern is that the annual cost of maintenance can be expected to go up each year, yet when the PC trust is fully funded, there will be no additional contributions to principal.

Therefore, liability is increasing while income is level. The trust may want to start investing in lottery tickets!

Remember what a PC trust is intended to provide for: perpetual care. The governmental authority doesn't want this cemetery to be theirs to care for someday. They want an authorized party to take care of it indefinitely.

Whoever is the owner at the time any previous liability is determined is "holding the bag." It doesn't matter that you paid $100,000 to purchase the business, if the trust is found to be underfunded, you are the party the regulators will come to in order to make the trust whole.

In many regards, this is akin to what happens when an environmental problem is discovered on a piece of property. You can pay $100,000 for an old gas station, but if it requires $1 million to deal with ground water contamination caused by leaking gas tanks, yours is the first pocket the government will go after. That is why before buying property you get an environmental audit.

Most people buying cemeteries never get a trust audit. The result is buyer beware.

In the 1990s I predicted that 90 percent of all PC trusts would be underfunded. I was mocked by some of my peers, but it is just simple math and lack of logic on the part of regulators setting funding levels. My prediction is just as relevant today as it was then.

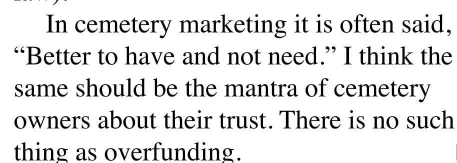
You also should know that the SBA will fund cemetery purchases, but the payback period has to be no longer than the period of the remaining inventory. This is usually not a problem, but in your case, it could be.

I would reconsider the value you are being offered to purchase the property. It makes sense the current owners don't want to be the perpetual care owners. They may have seen the annual costs of operation and maintenance and compared it to the trust earnings. They may be trying to get out before there is no one to buy it.

What is the solution? First, don't accept that meeting state law means a trust is well funded. That is a minimum requirement, not a maximum.

Hire a qualified firm to compute what the maximum should be while you have time (i.e. before there are no more lots to sell). Be prepared to amend your PC funding requirements to increase contributions to the trust for all future sales.

Then, review the trust investments. It might be you need to invest for some growth in the portfolio (subject to state law).



In cemetery marketing it is often said, "Better to have and not need." I think the same should be the mantra of cemetery owners about their trust. There is no such thing as overfunding. ❐