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Developing a Financial Plan For a Perpetual Care Fund

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

The key to evaluating your perpetual or endowed care fund can be summed up in three words: "Understand the situation." Is your cemetery most similar to Millennium Cemetery, Active Cemetery or Historic Cemetery, as described in Part 2 of this series? (See adjacent box.)

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Do you have an accurate picture of the adequacy of your perpetual or endowed care fund? Do you know whether funding rates from current and future sales are adequate? Do you have a detailed understanding of the expected cash flows of your endowment care fund over the next five, 10, 20 and 50 years? Only with this knowledge can cemeterians appropriately adjust business practices to best manage their endowment care situation.

The answers to these questions lie in a detailed model of perpetual care fund cash flows, which have three main components: deposits (based on cemetery revenue), investment return and withdrawals (based on fund investment return).

Perpetual care fund revenues and deposits are most difficult to model. Many factors can influence future perpetual care fund deposits, including changes in the age of the community's population, death rates, interest in various types of death care services, sales activity, economic conditions and preneed sales. An actuarial analysis will quantify the effects of these influences on both a short- and long-term basis.

Which best describes your cemetery?

- 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.

It is important to model all perpetual care expenses accurately in order for the cash-flow model to have valid results. Perpetual care expenses were described thoroughly in Part 1 of this series.

Perpetual care investment return and permitted withdrawals are directly influenced by the deposits and expenses included in the financial model for the cemetery. They are also influenced by the financial plan developed by the perpetual care fund portfolio managers and the cemetery managers. The perpetual care cash flow model must consider the influences of the financial plan on current and future investment return.

When they have a detailed understanding of the perpetual care fund's expected cash flows, cemetery managers should adjust the fund's financial plan. Below are six items they should keep in mind as they perform these adjustments:

• **Ensure an adequate contribution rate.** It is easiest for a cemetery to properly fund a perpetual care fund in lockstep with cemetery revenues. This is done by setting aside an adequate percentage of cemetery revenue to deposit into perpetual care funds. This practice has the advantage of smoothing out cemetery balance sheets. It is also the fairest approach from a social standpoint, since it guarantees that each purchaser of cemetery property pays no more than—and no less than—the full cost of perpetual care for that property. A small imbalance in the contribution rate can become a very large, solvency-threatening problem many years down the road. For this reason, contribution rate issues should be addressed swiftly.

• **Ensure that current perpetual care funds are adequate.** The problem of an inadequate perpetual care fund and some possible solutions were discussed in the Historic Cemetery example in Part 2.

• **Budget perpetual care fund income for major one-time expenses.** The significant impact these expenses can have on a perpetual care fund's liabilities were described in Part 1. Cemeterians should not ignore them when creating a perpetual care fund's financial plan.

• **Adjust perpetual care fund investment practices.** There are strict regulations on what funds may be withdrawn from a perpetual care fund. Cemetery managers should meet with their fund portfolio manager to best match the available funds from perpetual care fund investment return with forecasted perpetual care expenses. The cemetery and fund portfolio managers should also work toward "immunizing" the fund from interest rate risk. Simply put, the concept of immunization is a financial technique in which the investment mix of a portfolio is adjusted so the financial condition of the portfolio is unaffected by changes in interest rates. Finally, a perpetual care fund should be diversified so that its income is not overly affected by any one security.

• **Write the plan down and stick to it.** The perpetual care fund financial plan is a long-term one that must be methodically

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followed. All of the detailed understanding and sound financial planning in the world is worthless if the financial plan is not being followed. Cemetery managers should periodically verify that the perpetual care fund is indeed following the plan.

• **Periodically review the perpetual care fund condition, plans and goals; update the financial plan as needed.** Over time, new information becomes available, and revenues, expenses and investment return may change in unexpected ways. Every one to three years, cemetery managers should update their cash flow model to ensure current funds and contribution rates are accurate. Depending on the findings of the updated cash flow analysis, it might also be a good idea to fine-tune the financial plan in view of current economic and business conditions.

Using the Knowledge About Your Perpetual Care Fund Cash Flows

Creating a detailed picture of the cash flows of your perpetual care fund has obvious benefits: it helps you create a sound financial plan for the cemetery and allows you to ensure a stable, long-term profit flow. Other benefits from this process include:

• **Accurate valuation of your cemetery.** Depending on the value of the perpetual care fund, the fund may increase or decrease the total worth of the cemetery. Cemetery owners considering selling should be aware of the effect the perpetual care fund has on the property's value. They should also be prepared to present to potential buyers supporting evidence concerning the valuation of their perpetual care fund.

• **Education.** Some groups (e.g., regulators, consumer groups, IRS auditors, cemetery sales force) conclude that the perpetual care fund is a way for cemetery owners to hoard excess profits and avoid tax liabilities. That belief costs cemeterians and the cemetery industry goodwill. The best way to regain that goodwill is by educating people on the true costs of perpetual care.

• **Supporting analyses for legislative changes.** As I stated in Part 1, some cemetery perpetual care fund regulations are not sound. Cemetery trade groups and associations can use perpetual care fund cash flow analyses to help lobby for legislative changes that better serve the industry. Regulators can use these analyses to understand the full impact of any proposed cemetery legislation.

Further Help

Completing a financial plan for a cemetery perpetual care fund requires support from three types of professionals: cemeterians, casualty actuaries and financial planners.

Cemeterians may provide valuable insights concerning factors that may influence future cemetery cash flows. The best resources is state associations, since laws and other factors affecting cemetery management vary from state to state.

After the cemetery managers determine the general business conditions of their cemetery, they should share this information with a casualty actuary. Casualty actuaries have a unique combination of analytical, mathematical and business skills, making them invaluable to this type of project. Casualty actuaries perform these evaluations using mathematical models.

Additional information concerning actuarial models is contained in my Web site article "The Role of Actuarial Models in Business Decision Making," found at *www.hbactuarial.com*. Actuaries are also trained in investment strategy and can serve as a liaison between the business knowledge of the cemeterian and the investment knowledge of a financial planner. Links to actuarial resources can be found on my Web site, or by contacting my office directly.

Financial planners are usually necessary for actually carrying out the cemeterian's financial plan. For important analyses, it is best to use a Chartered Financial Analyst (CFA). CFAs possess expertise in financial accounting, quantitative analysis, fixed income and equity securities analysis, portfolio management and economics. The CFA will recommend and purchase specific financial securities to accomplish the goals of the financial plan. More information can be obtained from Casualty Actuarial Society, 1100 N. Glebe Road, Suite 600, Arlington, VA 22201; (703) 276-3100; *www.casact.org*.

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