PERPETUAL CARE PART 1

Perpetual or endowment care involves the continued preservation, improvement, embellishment and maintenance in a proper manner markers, lots, compartments, crypts or other space in a cemetery, columbarium or mausoleum.

How to Put Aside Enough Now To Cover Cemetery Costs Later

by Hayden Burrus

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

Table 1: Annual Expense $1,000

In a moderate inflationary environment of 5% per year, even a small annual expense of $1,000 will cost a cemetery almost $3 million during this century.

	4% annual inflation		5% annual inflation	
Year	Annual expense	Cumulative expense	Annual expense	Cumulative expense
2000	$ 1,000	$ 1,000	$ 1,000	$ 1,000
2010	$ 1,480	$ 12,486	$ 1,629	$ 13,207
2020	$ 2,191	$ 30,969	$ 2,653	$ 34,719
2050	$ 7,107	$ 158,774	$ 11,467	$ 219,815
2100	$ 50,505	$ 1,287,129	$ 131,501	$ 2,740,526

Perpetual care funds were originally established by some forward-thinking cemeteries. They were later mandated by virtually all state governments, with certain cemeteries, such as those run by religious or fraternal organizations, exempted. They are also referred to as endowment care funds, but for the purposes of this article we will use the term "perpetual care fund."

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The funds were created and are designed to ensure that enough money will be set aside from today's cemetery revenue to pay for the care of cemeteries in the future. To achieve that goal, a forward-thinking cemetery must do much more than simply set aside the state-mandated amount of money—or more than that amount. The money in the fund must be properly invested.

These funds must cover three very different types of expenses:

• **Continual, standard cemetery maintenance.** These expenses include mowing the cemetery grounds, regular custodial care, landscape and grounds maintenance and any other expenses that occur regularly, on a monthly, quarterly or annual basis. They are the easiest to work with and project. Although these periodic expenses may not currently be that high, the effect of costs rising slowly but indefinitely can be very significant. This is illustrated in Table 1.

• **Periodic "one-time" expenses.** These expenses include all maintenance and improvement expenses occurring on an infrequent and sometimes irregular basis. Examples include road repaving, major landscaping work and new roofing for cemetery buildings. Even when cemetery grounds are currently well maintained, the infrastructure gradually decays and requires major restoration efforts or replacement. Consider that if restoration work on cemetery structures must occur once every 20 years, the work must be done five times during the next century. At a cost (in today's dollars) of $25,000 to $50,000, the total cost for this work could be as high as $10.7 million after considering inflation. (With an inflation rate of 5 percent, a $50,000 restoration expense occurring every 20 years will cost $133,000 in 2020, $352,000 in 2040, $934,000 in 2060, $2,478,000 in 2080 and $6,575,000 in 2100.)

• **Unplanned, unexpected costs.** In addition to the expected expenses mentioned above, over the course of time, unexpected and sometimes catastrophic costs may be caused by fire, explosion, flood, earthquake, tornado, vandalism, etc. The trust fund must have the ability to pay for the repairs associated with these events unless the cemetery has insurance to cover all of these eventualities. The size of the policy deductible should rise as the value of the trust fund rises.

Regulations

As a part of my work with cemetery perpetual care funds, I have had the opportunity to speak with more than 40 regulators and legislators in jurisdictions across the United States and Canada. The laws in these jurisdictions have the same general structure, but the regulators' attitudes toward cemetery regulation vary widely.

Perpetual care fund regulations universally require a fixed percentage of sales to be contributed into the care fund. In most cases, this percentage varies between 10 percent and 20 percent. Some jurisdictions have different contribution rates for different categories of cemetery space. In addition, some jurisdictions require cemeteries to collect a fixed fee from each purchaser of cemetery property.

Funding of this type has many benefits, from an actuarial and financial viewpoint.

TABLE 2: INITIAL VALUE $100,000

An investment income maximization strategy can be catastrophic.

YEAR	VALUE OF TRUST FUND EMPHASIZING INVESTMENT INCOME	VALUE OF TRUST FUND EMPHASIZING TOTAL RETURN	LOST VALUE IF TOTAL RETURN IS NOT EMPHASIZED
2000	$ 100,000	$ 100,000	$ 0
2010	$ 183,354	$ 275,115	$ 91,761
2020	$ 336,185	$ 756,882	$ 420,697
2050	$ 2,072,273	$ 15,760,533	$ 13,688,261
2100	$ 42,943,147	$ 2,483,944,148	$ 2,441,001,000

First and foremost, it leads to the sharing of perpetual care expenses among all cemetery plot owners. It also results in social equity, since people purchasing more desirable (and costly) cemetery property contribute more toward the perpetual care of the cemetery as a whole. A further benefit of the percentage of sales contribution plans is that they are inflation sensitive—no adjustments need to be made to the legislation to account for the effect of inflation on the cost of perpetual care. As the expenses related to perpetual care rise, so will the cost of cemetery plots and the contributions to the perpetual care trust fund.

Some states do not require any funding of individual cemetery perpetual care funds by people who bought cemetery plots before the cemetery established a perpetual care fund (i.e. their exclusion from cemetery perpetual care fund legislation was grandfathered in). This addendum to perpetual care legislation is inherently unfair. It shifts the burden of funding the perpetual care of the entire cemetery onto future purchasers of cemetery property. This burden is especially great for property purchasers in cemeteries that are close to full capacity.

The specifics of legislation pertaining to contributions into perpetual care funds in most jurisdictions are based on political compromise and legislative fiat rather than sound actuarial and financial theory.

Investment practices for cemetery perpetual care funds are not usually specifically stated. Instead, they are governed by a doctrine known as the "prudent investor rule." This rule normally contains language similar to the following:

"In acquiring, investing, reinvesting, exchanging, retaining, selling and managing property for the benefit of another, a fiduciary shall exercise the judgment and care under the circumstances then prevailing which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds considering the probable income as well as the probable safety of their capital. Within the limitation of the foregoing standard, a fiduciary is authorized to require and obtain every kind of property ...."

In essence, this rule allows complete flexibility for the perpetual care fund investment officer to adjust investment practices as the condition of the fund and the financial climate change. It acknowledges that there are a variety of reasonable and intelligent investment strategies and allows investment strategies to change over time. It is sound legislation.

In contrast to the wide latitude the prudent investor rule provides, regulations governing withdrawals from perpetual care funds are very stringent and narrow. I have found no jurisdictions that permit any withdrawals of principal from perpetual care trust funds. The logic behind this is that contributions into perpetual care trust funds are intended to support cemetery maintenance indefinitely, therefore initial contributions should remain indefinitely. In most cases, this rule is sound and instrumental in ensuring the long-term solvency of perpetual care funds.

Most jurisdictions distinguish trust fund income between investment income (arising from interest and dividends on securities) and capital gains (arising from the increase in value of stocks, bonds and other assets). Withdrawal of capital gains is often prohibited by legislation, while withdrawal of at least part of the investment income is permitted. The investment vehicles generating the largest portion of their income through

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investment income are bonds and cash investments. The investment vehicles generating the largest portion of their income through capital gains are common stocks.

This distinction is arbitrary, unnecessary and harmful to the long-term solvency of perpetual care trust funds. All appreciation (or depreciation) in the value of a trust fund affects the trust fund equally, regardless of whether it comes from investment income or capital gains. This legislation, in effect, forces trust fund managers to ignore capital gains and adjust their portfolios to ensure that the investment income from the funds will be high enough to allow for the withdrawals the cemetery must make.

The time horizon for cemetery trust funds is very long. Vanguard Investment Group, the largest mutual fund provider in the world, advises in its brochure "Creating the Right Investment Mix": "The longer your investment time frame, the more you can ignore short-term risks and focus on long-term results. In other words, the further you are from your investment goal, the more it's worth taking risks with stocks." To further support that point, let me point out two additional items about the long-term performance of the Standard & Poor's (S&P) 500 common stocks:

- Between 1926 and 2000, there has been no 20-year historical period—not even during the Great Depression of the 1930s—when the bond market has outperformed the S&P 500.
- Between 1926 and 2000, there has been no 20-year historical period where the S&P 500 has not appreciated in value faster than inflation.

Ignoring the long-term potential for common stocks can be catastrophic. Consider two trust funds valued today at $100,000. One is focused on maximizing investment income; it has invested 90 percent of its portfolio in the bond market and 10 percent in common stocks. The other is focused on maximizing its total return without regard to the mix between investment income and capital gains; it has invested 90 percent of its portfolio in

common stocks, and 10 percent of its portfolio in the bond market. Table 2 shows the future values of each of these portfolios.

Table 2 illustrates that an investment income maximization strategy can be catastrophic. Even after a medium time horizon of 20 years, the investment income maximization strategy will cost the sample trust fund in this example over $400,000 in lost investment return—more than four times the value of the original investment. Over the 50- and 100-year time horizon, the loss is in the millions.

Coming next issue: The mismatch of perpetual care costs, cemetery revenues and perpetual care fund revenues.

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