

# THE FLAME

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*"For those who take their trust funds seriously."*

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Lawrence C. Anspach

## "GRAVE ROBBERS OR SAINTS"

or

**What is the real value of your cemetery?**

by

Lawrence C. Anspach, CCE

American Cemetery/Mortuary Consultants, Inc.

Periodically, Joliat & Company includes articles in *The Flame* that have been prepared by guest authors and that we believe will be of particular interest to our readers. In this issue we have included an article on cemetery appraisals, which highlights the importance of trust funds to a cemetery's

overall valuation. The article was prepared by Larry Anspach of American Cemetery / Mortuary Consultants.

As always, we welcome articles and contributions from our readers as well as suggested topics for future issues.

(Con't Pg. 2)

## Thought For Today

*"The quality of a person's life is in direct proportion to their commitment to excellence, regardless of their chosen field of endeavor."*

Vincent T. Lombardi

## SO WHAT IS A "CLOSED-END FUND" ANYWAY?

by

Jay F. Joliat, C.I.M.A.

*The purpose of "The Flame" is to present articles that address issues and topics that involve either the death care industry or investments in general. The following article addresses a general investment topic that has been an increasingly common subject of client questions.*

A somewhat obscure form of security, that has technically existed for quite some time, but has just recently enjoyed a major surge in popularity, is the "closed-end mutual fund." In the past ten years, over 100 closed-end mutual funds have been offered to the public with total assets of approximately \$50 billion. The huge

volume of new fund shares has significantly increased the public's awareness of this unusual investment vehicle's existence. However, few people, unfortunately, including those who invest their money in these fund shares, truly understand the unique nature of closed-end mutual funds. The

(Con't Pg. 6)



## Grave Robbers

(Con't from Pg. 1)

A professional independent appraisal is important to a death care business for a myriad of reasons. These reasons can be:

- The purchase of a cemetery
- The sale of a cemetery
- Estate tax planning
- Divorce
- Condemnation
- Partner buy-out
- Conversion from Not-for-Profit to For-Profit status (or vice versa)
- Analysis to pinpoint trends in profitability and loss for management

Whatever the purpose, whether your property is large or small, for-profit or not-for-profit, private or public, it is likely that one of these circumstances will eventually confront you.

Remember, the true value of any cemetery is what a willing buyer will pay for the business of a willing seller. An appraisal can help to determine this amount.

Recently, we appraised a cemetery for \$7,000,000. However, because it was poorly managed but a superb cemetery with very little competition, we felt that when sold it should bring a price of \$8,000,000. Our belief was also due to the fact that many buyers would compete to buy this cemetery, and thus increase the price. This is exactly what happened. It sold for \$8,000,000. The problems that relate to the valuation of a cemetery are indeed many and complex. The method used to determine the fair value of cemetery property is far different

from that used in other businesses. In evaluating a cemetery we are concerned more with the value of remaining lots (and unfunded liabilities) than we are with the present balance sheet.

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*Remember, the true value of any cemetery is what a willing buyer will pay for the business of a willing seller.*

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There are many factors that affect the valuation of a cemetery, both in a direct and indirect way. Some of these factors are:

- Inventory
- Sales Volume
- Collectibility of receivables
- Market conditions
  - Population
  - Competition
- Environmental issues
- Condition of buildings/roads
- Zoning
- Adequate records and bookkeeping
- Adequate trust funds

## THE IMPORTANCE OF TRUST FUNDS

Most people do not realize how trust fund accounting and trust fund management can affect the value of their businesses.

An important part of the appraisal process is to determine if a cemetery Endowment Care Fund (Perpetual Care Fund) is being funded adequately to

ensure future maintenance of the cemetery. If it is not properly funded (based upon the *current* market value of the fund, *not* the book value of deposits) this deficiency will lower the valuation of the cemetery.

If we determine that an Endowment Care Fund is underfunded, one of our recommendations to solve this problem is to increase the funding on interment and entombment rights, and to institute a care fund requirement on memorial sales if one is not already in existence. In addition, we suggest that the cemetery revise its investment practices and orient its trust funds more toward principal growth.

Therefore, in our analysis, if the trust is underfunded, we will determine what the shortage is on a yearly basis projected over the life of the cemetery. This amount could then be deposited annually to cure the deficiency. By making this assumption, the impact of the underfunding is reduced, but it cannot be eliminated and should not be ignored.

Pre-need and pre-construction trusts are also important in determining the value of a cemetery. We often see such funds that have been mis-managed or underfunded. Such problems ultimately reduce income to the cemetery, which in turn must result in a lower valuation. Deficiencies in these trusts, either due to a failure to make appropriate deposits or to an insufficient growth in market value in the funds, represent real liabilities of the cemetery that



negatively impact the purchase price. (NOTE: The record keeping of some cemeteries is so poor that they don't even really know what their pre-need obligations and liabilities are!)

While it is important that the cemetery fulfill its legal trusting obligations, mere compliance is not necessarily sufficient. The pre-need or pre-construction fund must be able to cover the actual future cost of providing the merchandise, services or construction. If the fund does not, then an offsetting liability should be reflected on the cemetery's balance sheet.

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*While it is important that the cemetery fulfill its legal trusting obligations, mere compliance is not necessarily sufficient.*

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A case in point: A cemetery we appraised would have had a value of well over a \$1,000,000; however, the cemetery had unfunded merchandise liabilities of \$800,000. This deficiency resulted in a valuation of only \$300,000. Had the trust been properly funded, the business would have been easier to sell and worth significantly more to the owners. Trust fund deficiencies are one of the biggest factors that scare away potential high quality purchasers.

This same problem can occur in the case of Endowment Care Funds. Based upon our appraisal, we often determine that

Endowment Care Funds, which are "fully funded" according to state law, may be severely underfunded from a "real" economic standpoint. This situation often arises when a cemetery has made relatively few lot sales in recent years and/or has experienced little appreciation in the principal value of its funds.

As you can see, a high volume of sales helps to give your cemetery a higher valuation in two different ways. It increases your current profitability and provides for a larger Endowment Care Fund.

## CAPITALIZATION RATES

Other than the direct or indirect factors, what is the "glue" that may result in a high or low valuation?

The capitalization rate! This rate is determined by a number of factors. The capitalization rate is often referred to inaccurately as an "interest rate," whereas it should be referred to as a "discount rate" or a "present worth factor."

To convert future income to present value, establishing the proper capitalization rate is essential. The rate must reflect the risk of ownership, the return enjoyed by other similar properties, and the return available from other investments.

The higher the quality of a property, the lower the capitalization rate, the higher the valuation. A higher capitalization rate results in a lower valuation and vice versa.

The "Inwood Factor" has customarily been applied to cemeteries. A table of coefficients published by William Inwood is a widely accepted source for obtaining the income factor related to a specific capitalization rate. For example, using this process the present worth of an annuity of \$1,000 each year, payable at the end of each year, for a term of four years, discounted at 8%, is found to be \$3,312.12. In other words, if an investor were to pay \$3,312.12 in cash today for the privilege of collecting \$1,000 at the end of each year for a term of four successive years, he would be receiving 8% interest per annum on his investment.

## NON-LIQUIDITY

Historically, Julius Finkel, a noted authority on cemetery appraisal, wrote over 30 years ago that you must take into account in determining the proper capitalization rate the "non-liquidity" of cemeteries and the many years required to dispose of the assets.

Since that time, however, many changes have taken place in the death care industry. The entry of public corporations, limited partnerships, venture capital groups, and numerous other "buyers" into the marketplace has made the cemetery business almost as "liquid" as any other business. Because of the increase in competition in most fields of business and the relative absence of severe competition in the cemetery business, along with the

(Con't Pg. 4)



## Grave Robbers

(Con't from Pg. 3)

increasing value of large land holdings, the cemetery business has increased in its appeal to business buyers. In addition, the increase in the population of persons in the upper age brackets (particularly in some areas of the country), has had a considerable effect on reducing the expected time that will generally be required to sell out cemetery lands and assets. The shorter the projected life of a cemetery's inventory, the greater the inventory's present value.

## AN APPRAISAL IN ACTION

Below is a simple example that may help to explain some of the basics of how an appraisal is performed and the importance of the capitalization rate. An appraisal we recently performed for a small cemetery (5 acres) for purposes of a buy-out between partners had an unusual result. To protect the confidentiality of the client, all names and geographic data have been omitted. However, what is presented are the actual facts.

We appraised the cemetery for \$48,000. One of the partners was dissatisfied with the appraisal, so the other partner hired a local real estate appraiser, who admitted that he had never appraised a cemetery. He valued the cemetery at \$250,000! Clearly, a significant difference. How can this be? For purposes of this article, we will analyze how two appraisals of the same cemetery can result in such a wide variance.

First, the reader must understand that generally it is most appropriate to appraise a cemetery using the "Income Approach." This method has been upheld in the courts. Some states have even gone so far as to specify in their statutes that the proper method to appraise a cemetery is the "Income Approach."

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*To convert future income to present value, establishing the proper capitalization rate is essential.*

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According to this method, the estimate of a single representative year's income is converted to a value of the business by applying an appropriate capitalization rate. The capitalization rate, which is expressed as a percentage, is translated to an income factor (or coefficient), which is then multiplied by the projected annual income to arrive at the valuation.

Normally, we like to examine at least five years of financial statements to arrive at a "projected income." In the case of this cemetery they had no profits during the last five year period (see table on following page, ABC Cemetery). So what do you do then?

The "Asset Method" is used. This method involves analyzing the balance sheet of the cemetery and establishing the market value of its assets, which may be different than their "book" value. Receivables are evaluated for

their collectibility; property and equipment are stated at their market value, if available; and inventories are valued based on their income producing potential. Unusual items, such as assets for the benefit of related parties (e.g., shareholders) are eliminated. The resulting asset value is offset against the underlying liabilities.

Surprisingly, our appraisal and the appraisal of the local real estate appraiser were actually very similar, with one major difference. To his credit, he did quite a bit of research and realized that the "Income Approach" is the proper method to appraise a cemetery. As discussed earlier, we used the "Asset Method" because there was no income. Listed below are the assets and liabilities of the cemetery, based upon our analysis, and the resulting asset valuation:

### Assets

Cash	\$1,000
Accounts Receivable-net	1,500
Inventory of Monuments	7,600
Inventory Value of Land	8,000
Property and Equipment	<u>30,500</u>
Total Assets	<b>\$48,600</b>

### Liabilities

Accounts Payable	400
Accrued Expenses	<u>200</u>
Total Liabilities	<u>600</u>
Net Asset Value	<b>\$48,000</b>

What was the one major difference?



The cemetery has 8,000 developed single depth grave spaces, and sells an average of 15 spaces per year. At this rate, it will take the cemetery 533 years to sell all available spaces. We valued the remaining inventory at \$8,000 based on the "Income Method" of projecting an annual profit, and capitalized it over 100 years.

The local real estate appraiser appraised the assets (with the exception of the inventory value of the land) at \$35,000. We were only \$5,000 apart. However, since the cemetery had no income, he projected, unrealistically, that the cemetery would sell 104 grave spaces each year over the next 75 years. This projection resulted in a net income that was then capitalized. The final result was that the remaining inventory was valued at \$215,000, rather than \$8,000! If a cemetery has averaged 15 grave sales per year for the last

five years, it is not proper to assume that 104 grave sales will be sold per year for the next 75 years. Also, since he was not familiar with typical costs in the death care industry, he used improper costs and expenses in his analysis. The partners eventually resolved their differences.

*For purposes of this article, we will analyze how two appraisals of the same cemetery can result in such a wide variance.*

## AN APPRAISAL CHECKLIST

For informational purposes, the following are some of the contents of a cemetery appraisal.

1. Letter summarizing findings
2. Table of contents
3. Qualifications for appraisal
4. Explanation of the "Income" or "Asset" Approach to appraisal and why it was used
5. Statistics and informational background on the cemetery
  - Date founded
  - Present officers
  - Total # of deeded lot owners
  - Total # of interments
  - Annual rate of interments
  - Insured value of buildings, features, equipment, and description of same
  - Total in endowed or perpetual care fund, pre-need fund, pre-construction fund, etc.
  - Total amount of accounts receivable
  - Total acreage - developed & undeveloped - total # of spaces & crypts remaining for sale in developed area & dollar inventory of same
  - Type of roads (paved or gravel)
  - Organizational structure - corporate entities
  - Landscaping & unusual features & structures
6. Computation and findings
  - Future expected life of the cemetery
  - Inventory of existing spaces & crypts in developed sections
  - Total potential spaces and crypts to be developed in undeveloped acreage
  - Rate of annual sales for all merchandise and services
  - Interpretation of above data and determination of its application
  - Calculation of life of the cemetery
7. Annual profit factor
  - Annual operating statements reviewed for last five year period to derive net income before taxes.

## ABC Cemetery Historical Operating Results

	1986	1987	1988	1989	1990*	1986-1990 AVERAGE	AVG. %
<b>SALES</b>							
MONUMENTS AND LOTS	\$39,782	\$41,771	\$43,860	\$46,053	\$35,211	\$41,335	100.0%
<b>TOTAL SALES</b>	<b>39,782</b>	<b>41,771</b>	<b>43,860</b>	<b>46,053</b>	<b>35,211</b>	<b>41,335</b>	<b>100.0%</b>
<b>COST OF SALES</b>							
MONUMENTS AND LOTS	25,020	26,271	27,585	28,964	30,412	27,650	67%
<b>TOTAL COST OF SALES</b>	<b>25,020</b>	<b>26,271</b>	<b>27,585</b>	<b>28,964</b>	<b>30,412</b>	<b>27,650</b>	<b>67%</b>
<b>GROSS PROFIT</b>	<b>\$14,762</b>	<b>\$15,500</b>	<b>\$16,275</b>	<b>\$17,089</b>	<b>\$4,799</b>	<b>\$13,685</b>	<b>33.1%</b>
<b>OPERATING EXPENSE</b>	<b>37,218</b>	<b>39,079</b>	<b>41,033</b>	<b>46,373</b>	<b>43,956</b>	<b>41,532</b>	<b>100.5%</b>
<b>OPERATING INCOME (LOSS)</b>	<b>(\$22,456)</b>	<b>(\$23,579)</b>	<b>(\$24,758)</b>	<b>(\$29,284)</b>	<b>(\$39,157)</b>	<b>(\$27,847)</b>	<b>-67.4%</b>
<b>OTHER INCOME</b>							
SERVICE SALES	7,410	1,980	0	0	0	2,112	5.1%
INTEREST INCOME	250	150	0	0	0	91	0.2%
MISCELLANEOUS	85	85	0	0	0	46	0.1%
GAIN ON SALE OF EQUIP.	0	0	0	0	1,921	395	1.0%
<b>NET INCOME (LOSS) BEFORE TAXES</b>	<b>(\$14,711)</b>	<b>(\$21,364)</b>	<b>(\$24,758)</b>	<b>(\$29,284)</b>	<b>(\$37,236)</b>	<b>(\$25,203)</b>	<b>-61.0%</b>
<b>GROSS PROFIT % OF SALES</b>	<b>37.1%</b>	<b>37.1%</b>	<b>37.1%</b>	<b>37.1%</b>	<b>13.6%</b>	<b>33.1%</b>	
<b>NET INCOME % OF SALES</b>	<b>-37.0%</b>	<b>-51.1%</b>	<b>-56.4%</b>	<b>-63.6%</b>	<b>-105.8%</b>	<b>-61.0%</b>	

\*1990 DATA IS ANNUALIZED BASED ON 10 MONTHS ACTUAL

(Con't Pg. 6)

## Grave Robbers

(Con't from Pg. 5)

- If profit factor cannot be secured from adequate experience (sufficient financial statements), it may be estimated by a percentage system utilizing cost allocations to the various items of cemetery expense.
  - Selection of a proper capitalization rate:
    - Liquidity of cemetery
    - Stability of cemetery
    - Size of market area and competition
    - Degree of Risk
    - Population trends
    - Analysis of endowed care fund
  - Application of capitalization rate
    - Inwood coefficient
  - An "Asset" valuation comparison is made to support the Income Approach to valuation.
8. Appendices
- Geographic location of the cemetery
  - Legal description, if available
  - Aerial view of the property, if available
  - Maps
  - Photographs
  - Sales literature
  - Demographics

Remember, it is important to hire independent professionals when making decisions that can affect the value of your business. Whether it is a professional money manager for your trust funds, a professional cemetery appraiser, a professional sales manager, a lawyer, accountant, etc., there is no substitute for a specialist who knows each aspect of your business.

Now that you know about appraisals, have you had **GRAVE ROBBERS OR SAINTS** working for you?

*For eighteen years, Lawrence C. Anspach has visited cemeteries and funeral homes throughout the United States and abroad, keeping in touch with changes in value, improvements, trends, and the patterns of the death care business. Mr. Anspach currently serves on the Board of Directors of the American Cemetery Association, and also serves on the Board of Directors of the Pre-Arrangement Association of America. Mr. Anspach is a Certified Cemetery Executive.*

*From 1973 to 1986, Mr. Anspach served as Executive Vice President and Chief Operating Officer as well as owner of Cedar Park Cemetery and Funeral Home in Chicago, Illinois. He is a past President of the Illinois Cemetery Association, and past Secretary-Treasurer of the Cemeteries Association of Greater Chicago.*

*American Cemetery/Mortuary Consultants routinely performs appraisal work in connection with cases of land condemnation, tax appraisal, business evaluation, etc.. American Cemetery/Mortuary Consultants also brokers the sales of cemeteries and funeral homes, and is the listing agency for many buyers and sellers of cemeteries and funeral homes. □*