



THE CITY OF SAN DIEGO

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## OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Date Issued: October 18, 2013

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# Income from the Mt. Hope Cemetery Perpetuity Fund in Support of Perpetual Care and Upkeep of the Cemetery

## OVERVIEW

On April 24, 2013, the Rules Committee received an update from the Funds Commission regarding the six trust funds they oversee and administer in accordance with City Charter Section 41(a). One of the six trust funds, the Mt. Hope Cemetery Perpetuity Fund, is described and governed by provisions within City Charter Section 55. Specifically, Charter Section 55 stipulates that 1) the principal of the Cemetery Perpetuity Fund may never be used for the maintenance or upkeep of the cemeteries and 2) all income derived from the investment of monies in the Cemetery Perpetuity Fund shall be expended for the maintenance or upkeep of the cemeteries.

Charter Section 55 further provides that at least 20% of net proceeds from the sale of all cemetery lots be deposited in the Cemetery Perpetuity Fund. If investment income and cemetery fees are insufficient to cover cemetery operations, Charter Section 55 requires the Council to annually appropriate revenues in “an amount sufficient to enable the City to provide perpetual care and upkeep of all graves and lots in the cemeteries.”

Given Councilmember questions and concerns related to the long-term financial viability of the Mt. Hope Cemetery, the IBA was asked to report on the funding sources for cemetery operations and the amount of General Fund subsidy required to properly maintain the cemetery. Additionally, the IBA was directed to work with the City Treasurer and report back to the Committee on possible options, tools, or other formulas for growing the Mt. Hope Cemetery Perpetuity Fund.

# FISCAL/POLICY DISCUSSION

## Mt. Hope Cemetery Revenues and Expenses

There are two main sources of revenue to fund cemetery operations. The first is net revenue from cemetery sales, fees and services. The cemetery generates operating revenue from the sale of lots (80% of each lot sale is retained for operations) and from burial related services (opening and closing, handling, recording, etc.). The second main revenue source is the income disbursement from the Mt. Hope Cemetery Perpetuity Fund. In accordance with City Charter Section 55, all income earned by the Perpetuity Fund is transferred into a cemetery operations account.

As shown in the table below, these two sources of revenue are insufficient to cover the total costs of cemetery operations. City Charter Section 55 requires the City Council to approve sufficient appropriations to properly maintain the cemetery. The General Fund covers the annual operating shortfall. Since FY 2009, the amount of the annual General Fund subsidy has ranged from \$227,000 to \$513,000.

<b>Mt. Hope Cemetery</b>						
General Fund	FY 2014 Budgeted	FY 2013 Estimated	FY 2012 Estimated	FY 2011 Estimated	FY 2010 Estimated	FY 2009 Estimated
<u>Revenue</u>						
Fees	\$665,000	\$634,949	\$617,431	\$670,398	\$733,834	\$770,128
Perpetuity Income	\$385,000	\$453,633	\$411,882	\$410,877	\$406,049	\$400,185
Total	\$1,050,000	\$1,088,582	\$1,029,313	\$1,081,275	\$1,139,883	\$1,170,313
<u>Expenses</u>						
Salaries	\$461,629	\$412,639	\$518,668	\$459,927	\$452,237	\$468,898
Fringe	\$391,774	\$288,391	\$412,396	\$372,397	\$342,159	\$282,454
NPE	\$352,278	\$614,333	\$611,733	\$606,350	\$734,366	\$719,523
Total	\$1,205,681	\$1,315,363	\$1,542,797	\$1,438,674	\$1,528,762	\$1,470,875
Difference (GF subsidy)	(\$155,681)	(\$226,781)	(\$513,484)	(\$357,399)	(\$388,879)	(\$300,562)

## Cemetery Capacity for future Burial Services

Given that net revenue from cemetery sales, fees and services is used to fund operations and maintenance, Councilmember Emerald asked about the cemetery's capacity to provide burial services in the future. Based on average annual burials and a recent count of the remaining plots available, Park & Recreation Department staff responsible for cemetery operations estimate the cemetery has burial capacity for another 42 years. Although there has been some decline in operational revenue in recent years, it is reasonable to assume the receipt of this revenue will be relatively consistent going forward.

## **Income from the Mt. Hope Cemetery Perpetuity Fund**

The Funds Commission is responsible for supervision and control over all trust, perpetuity and investment funds of the City. With guidance from an investment consultant (currently Mike Laven of Canterbury Consulting), the Funds Commission directs the investments of the Mt. Hope Cemetery Perpetuity Fund through its custodian, Northern Trust. The Funds Commission has established a longstanding portfolio allocation target of 65% bonds and 35% stocks. The Commission's goal for the Cemetery Perpetuity Fund is to generate annual investment income of at least 5% for the cemetery; however, that goal has been difficult to achieve in recent years given low interest rates in the bond markets.

The City Charter constrains the Cemetery Perpetuity Fund to invest only in income-producing securities (primarily bonds and dividend-paying stocks). If the Cemetery Perpetuity Fund were permitted to invest in stocks that don't pay dividends (which often realize greater gains), it may be possible to more aggressively grow the principal/size of the Fund. Such a change would require a voter approved amendment of the City Charter.

There are two important points to consider in contemplating a change to allow investment in stocks that don't pay dividends. The first is that the change involves sacrificing dividend income (which is transferred to fund cemetery operations) in return for greater potential principal growth. While growing principal strengthens the perpetuity of the Fund, it also reduces cash flow to the cemetery thereby increasing the size of the required General Fund subsidy. The second point is that stocks that don't pay dividends tend to be riskier (have greater price volatility) than dividend paying stocks. So while it is possible to grow principal faster, there is an accompanying risk of greater principal reduction.

## **Considerations related to Possible Options for Increasing Income from the Mt. Hope Cemetery Perpetuity Fund**

Concerned about the long-term financial viability of cemetery operations, the Committee has asked if any options exist for increasing income from the Cemetery Perpetuity Fund without taking on significantly greater risk. The IBA has discussed possible options for increasing investment income with the City Treasurer and Investment Advisor Mike Laven. We collectively agree that while options may exist, they typically involve assuming greater investment risk and often require a tradeoff between principal growth and investment income.

For example, if the Charter were to be amended to allow investment in stocks that don't pay dividends, the Fund may be able to more aggressively grow its principal. In order to offset the loss of dividend income, Mr. Laven has suggested that the Charter could be further amended to allow for a partial distribution of principal gains (i.e., whenever annual principal gains exceed 5%, they are transferred to pay for cemetery operations). In this scenario, whenever the Fund experiences significant principal gains, principal gains in excess of 5% are distributed to finance cemetery operations and 5% is retained to grow the Fund. While this sounds like a good option, it is important to remember that the Fund will have assumed more market risk which can result in more rapid erosion of Fund principal and no income during market downturns.

There is also a tradeoff between risk and return. The Funds Commission could direct the Fund to invest in bonds with a lesser credit rating in order to receive higher dividend income. However, there would be a greater risk of default on dividend payments, and the market value of bonds could be subject to greater price fluctuations under certain market conditions.

A final consideration is market or interest rate risk. We are in a historically low interest rate environment. Bond prices react inversely to interest rates. If interest rates were to begin to rise, the market value of bonds held in the Fund would decline resulting in a reduction of principal. While there are a number of ways this risk can be partially or fully mitigated, interest rate risk should always be monitored and managed.

## CONCLUSION


The Mt. Hope Cemetery is an important public asset that provides affordable burial services to the public. For many years, cemetery operation and maintenance costs have exceeded the amount of revenue dedicated to its support including income earned and distributed from the Cemetery Perpetuity Fund. In accordance with City Charter Section 55, the General Fund has covered the operating deficit. The annual General Fund subsidy has ranged from \$227,000 to \$513,000 since FY 2009.

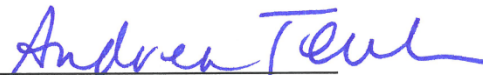
At the April 24<sup>th</sup> meeting, the Committee requested the IBA work with the City Treasurer to report back on options for possibly growing income from the Cemetery Perpetuity Fund in order to better support cemetery operations. Having discussed various options with both the City Treasurer and the investment consultant for the Funds Commission, the IBA does not believe that investment income can be significantly increased without a corresponding increase in risk to Fund principal. Additionally, amending the City Charter to more aggressively grow Fund principal may result in a reduction of dividend income to support cemetery operations.

In keeping with Council Policy 000-26, the Funds Commission will be making its semi-annual report to the Rules Committee on October 23, 2013. Their investment consultant, Mike Laven of Canterbury Consulting, plans to attend the meeting. The IBA recommends the Committee ask the Chair of the Funds Commission and Mr. Laven to comment on the following topics as they specifically relate to the Mt. Hope Cemetery Perpetuity Fund:

- Any opportunities for enhancing income without a Charter amendment?
- Any other options for increasing income without significantly increasing risk?
- How is interest rate risk currently being monitored/managed?

There may be other reasonable investment options to grow Cemetery Perpetuity Fund income in support of cemetery operations; however, the IBA defers to the Commission's investment consultant to comment on these options. Although the Fund (like all investment funds) is subject to some market risk, the IBA believes it is currently being conservatively managed in accordance with the City Charter and that Fund perpetuity is being safeguarded. Finally, we would note that continued annual contributions to the Fund from cemetery plot sales and the possibility of higher market interest rates in the future could significantly reduce the annual General Fund subsidy.

  
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