Investing in Trusts: Why Andrew and I Don't Own Them, Why You Probably Won't Want to Too – And How to Get Started if You're Sure This is Really an Area You Want to Explore

Someone asked me a question about trusts:

"I was watching one of your past podcasts and you mentioned you would not buy dividend stocks for an income portfolio you would buy trusts. How would I go about or is it possible to research and possibly purchase these? I found that idea fascinating."

The best trusts are usually illiquid and a bit difficult to find. You have to do a little research on them and what backs them. Some examples of the kinds of trusts I was talking about are:

Beaver Coal (BVERS) - Mainly royalties on met coal, timberland, and rental income (variety of business, etc.) in and around Beckley, WV

Mills Music Trust (MMTRS) - Royalties on old songs like "Little Drummer Boy"

Pinelawn Cemetery (PLWN) - Interest in proceeds from sales of burial plots in one cemetery on Long Island, NY

Things like that.

Many investors avoid these because they complicate your taxes. You'll need an additional form from each trust you own (they should send it to you, if they don't - you'll contact them and request the form). And it may sometimes cause you to request late filing of your taxes.

For this reason, partnerships (like the one Andrew and I run) and professional investors running managed accounts (like the ones Andrew and I manage) will avoid buying these trusts simply because they don't want to lose clients through annoying the client with additional tax work for the client. As a result, many professional investors who may know of and like these trusts (and even own them personally) won't buy them for clients. This can keep the price of the trusts reasonable. These stock prices (technically they are trust certificates, not stocks) tend to bounce around in price.

It is best to only buy them when the yield on the trust (making sure you check to see if the distribution recently is similar to what it is normally) less the rate you'd pay on taxes still makes it make sense. For example, say you want an 8% annual return in the trust certificate and you pay 30% in taxes on income from a trust, then you don't want to buy when Distribution/Price is anything worse than 11.5%.

Often, your total return in the trust is not going to be great compared to buying and holding a stock that is actually retaining its earnings.

However, it is true that for income purposes only - these trusts will often yield more than the dividend yield you can get on other kinds of stocks, the yield you can get on preferred stocks, the interest rates you can collect on bonds, etc.

But, keep in mind five things:

1) Owning these will complicate your taxes

2) Income from trusts is usually less tax efficient - you'll pay more in taxes - than creating income by buying and holding stocks and selling them when you need income

3) The best trusts are usually totally illiquid - so, you need to look at these like you would outright purchases of entire bonds, etc. (not like ownership of a liquid trust, a bond fund, etc.)

4) Income from trusts will often be extremely low growth, could decline over time etc. -- look carefully at the assets producing the cash flows these trusts pay out

5) Some trusts will eventually pay out all income and have nothing valuable left over (for example, one day Mills Music Trust's songs will be off copyright and income will drop to nothing and leave no residual value)

<u>The remaining life of the trust is very important.</u>

I’ve seen cases – though, admittedly it is in somewhat more actively traded trusts – where I believe the people buying into the trust are vastly overestimating the remaining life of the trust. Or, maybe they are just buying based on today’s yield and not reading any of the disclosures the trust makes. A trust with a short life could have a 20% or 30% yield and still be unattractive, because – unlike a bond – it is not going to pay you a lump sum at maturity.

On the other hand, some trusts may have longer lives than people assume.

For example, met coal royalties from Beaver Coal will eventually disappear - but that trust actually outright OWNS the land (not just the mineral rights), so the trust will still have surface ownership of 50,000 acres of land in and around Beckley, WV even after met coal royalties drop off. The distributions Beaver Coal has paid out have come very, very little from any sales of land. Mostly, they’ve been distributing royalties. They’ve sold off very little land over time. So, in a sense there is a “residual value” at Beaver Coal in the sense that land is carried on the books that is not being liquidated at present to pay distributions. That’s not the situation at Mills Music Trust. Those are basically “self-liquidating” assets because eventually songs do come off copyright and enter the public domain. Mills has a list of its top songs and years when the copyright expires. So, make sure you read that and understand it. Don’t count on royalties on a song that is going to be off copyright unless that copyright has a lot of years left on it.

Some people I know have done work on Pinelawn Cemetery and believe that the cemetery has a large amount of land people haven't been buried in that will last many, many, many decades. But, I have not visited the site or spoken with anyone at the cemetery myself - so, I can't confirm this.

I have visited Beckley (home of Beaver Coal). I’ve seen the assets the company owns. And Andrew spoke very briefly to the general manager of Beaver Coal. So, I have a little bit more insight into the longevity of that trust.

Obviously, you would want to create a diversified and uncorrelated revenue stream.

So, combining:

1) Old music

2) Met coal

3) Burial plots

Would be a good kind of mix, because I can't really see how nostalgic music and met coal and value of burial plots have anything in common. What you wouldn't want to do is only buy income that is all tied to the same commodity, the same type of real estate, etc.

This is a specialized area.

You can do well if you choose to focus on overlooked trusts.

But, it's something you'd need to spend time working on yourself.

You aren't going to find helpful information online about these kinds of situations the way you might in more general stock ideas in good businesses that compound over time or value stocks or something like that. A few have been written up a little. Mills is SEC filing, so there are Seeking Alpha write-ups and stuff like that I think. There was a write-up by David Flood (Elementary Value Blog) for Beaver Coal. Trey Henninger (DIY Investing) has done stuff on Pinelawn. But, generally, there’s not a lot of info on these things and you’ll be doing your own homework.

Having said that, yes, I personally would look at these kinds of trusts instead of bonds or preferred stock if I needed to have income (not capital gains) for my own personal portfolio.

I DO NOT own these trusts myself, because I don't invest for myself outside of the fund that I run with Andrew. And because, like I said, funds like mine basically don't buy these trusts because the cost of annoying clients with tax complications would harm our business's assets under management by far more than any returns we could get from owning the trusts. So, these are not appropriate investments for professional investors running money for other people. These are really only good choices for individual investors who choose to specialize in these kinds of trusts.

Yes. It's possible to research them. Several file with the SEC. Others report disclosures (non-SEC) with OTCMarkets. The best place on any obscure / over the counter / non-SEC filing / dark etc. security would be to go to OTCMarkets.com and then type in the ticker for the trust you're interested in. Then, go to the disclosures tab on that stock's page. You can also contact many trusts directly by calling their office. Trusts also use someone (it's going to tend to be a bank) to handle the trust as well. So, there will be disclosures at OTCMarkets.com, sometimes at their own website (Beaver Coal has a website, many of these trusts don't), and then by directly calling the office that is running the trust's affairs day-to-day. Some day-to-day operations are meaningful (like Beaver) and others consists of little more than collecting money coming in and paying money out (Mills Music Trust, for example). You may also be able to find lists of the trusts other holders and contact them. It's up to them if they will or won't talk to you about their experience holding the trust. But, for SEC filing trusts - the major holders are not a secret. The disclosures are usually minimal. But, there are some of these -- like Mills -- that do, in fact, file with the SEC.

Finally, any trust that owns real estate assets can be analyzed directly by visiting the site. So, you can just go in person to view any land for yourself. There are also land records. And for mineral resources – there are state, government, and trade association records you may be able to find. Even if management will not speak to you, it is probably possible to find regulatory info that can be correlated with some degree (though not 100%) confidence with the company's filings such that you have an idea of coal production in that country, the financial condition of a certain cemetery, etc.

There's nothing magical about the 3 trusts I mentioned.

They're just a sample of the kinds of trusts I was talking about. These are things that were created a long time ago and then aren't really promoted to investors. Unless you have very good reason to, I'd avoid the bigger trusts that are marketed to investors and increase their certificate count over time. The best opportunities - or at least the simplest to figure out you're getting an adequate return - are things that were created a long time ago and then do nothing to reach out to investors. Again, I would caution that I don't believe these are usually superior on an after-tax basis to buying and holding stocks and then selling what you've bought and held to create income. But, if you have your heart set on collecting income -- it may be easier to get a better margin of safety in these kinds of trusts than in better known and more liquid income paying securities like bonds, preferred stocks, and well-known trusts. That's because better known securities tend to get picked over for yield pretty severely. So, they are bid up to yields that just aren't attractive. Sometimes the more obscure trusts offer better yields. But, again, check to make sure you've calculated your AFTER-TAX yields on these things. Your own tax situation will vary from others. And I can offer no suggestions on tax matters personal to you.

Ask Geoff a Question of Your Own