6/06/2012

Eight Ways To Make Collecting Pay Off **(Leave heirs a road map)**

This article appears in the June 25, 2012 Investment Guide issue of FORBES magazine with the headline, "Hobbyists' Reward."

Robert Byers keeps some of his mineral specimens on display and others in a sauna converted to storage. Credit: Timothy Archibald for Forbes

Robert Byers, a spine surgeon, started collecting minerals as a boy when his father took him on geology field trips. For his 12th birthday he got a 12-pound sledgehammer. Since then Byers, now 60, has assembled some 2,500 pieces, most of them kept in boxes in a sauna converted to storage at his San Francisco home.

With minerals prices skyrocketing during the past decade "it's becoming harder to afford great rocks," he says. So Byers has shifted his focus to building a locality collection (samples from all over the world) of stibnite—a silvery gray crystal that is relatively inexpensive and less in demand.

They're not liquid and no sure thing, but collectibles (a.k.a. tangible personal property) can be a profitable investment. Rare instruments, for example, have doubled in value during the past ten years, and vintage wristwatches have gone up by about 5% per year. In baseball card collecting the Honus Wagner is the holy grail; last year Arizona Diamondbacks owner Ken Kendrick paid a record $2.8 million for the highest-graded one in existence.

Minerals, in particular, are so hot that Dallas-based Heritage Auction Galleries created a new department for them in March and plans to hold two mineral-only auctions per year. The finest specimens of tourmaline, rhodochrosite and crystallized gold are fetching more

than $1 million apiece—about five times what they sold for five years ago, Heritage says. (See "If Facebook Delivers (Or Disappoints), Try Minerals.")

Of course, celebrities and the superrich can afford to lavish big dollars on collectibles without worrying about the monetary returns. Jay Leno has his cars. Billy Crystal paid $239,000 at a Sotheby's auction in 1999 for a 1960 Mickey Mantle baseball glove. Billionaire real estate investor and developer Alan Casden collects antique Jewish coins, while Bruce Halle, founder of Discount Tire (and No. 96 on The Forbes 400 list), has, appropriately, the world's most comprehensive collection of tire posters.

But what about regular folks who can't shell out such big bucks and want to maximize the return on their collectibles? Rule number one: If something is touted as "limited edition" or "collectible" it probably isn't, says Perri Capell, owner of the Boise, Idaho liquidation company Estate Sales Solutions. Beyond avoiding obvious schlock, here are some other key points, distilled from interviews with numerous successful collectors and their advisors.

1. Buy, hold and trade up

Don't try to time the market by investing on the basis of current fads or what you think will be the next hot item. Instead, collect for the long haul. Ed Dempsey, 50, a money manager with Pension Partners in New York, owns more than 100 watches, mostly dating from 1950 to 1970. During his 20 years collecting he has pared and added timepieces as his taste has changed and budget has expanded.

Dempsey sticks to brands that are most in demand (and therefore more liquid), such as Rolex, Patek Philippe, Vacheron Constantin and Cartier. He keeps them in a vault and rotates them into his wardrobe a few at a time. "As an alternative currency, these are watches that you could take to any capital city in the world and sell," he says.

2. Curb your compulsions ...

People collect for a variety of reasons besides making money: to achieve status (for instance, to be able to say they own Rusty Staub's game-worn warm-up jersey); because they're drawn to a particular type of item or genre of art; or out of a desire to own a piece of history or complete set (for example, by collecting every penny minted in the U.S.). When emotions take hold, collectors can overpay and overspend—to the point of financial ruin.

The late psychoanalyst Werner Muensterberger serves up some pathological examples in his book Collecting: An Unruly Passion (Princeton University Press, 1993). They include Thomas Phillipps, a 19th-century British book collector who abandoned his family, then

made financing his insatiable habit the main criterion in courting a second wife. Muensterberger, who collected African art, believed that the pursuit of objects helps compensate for deep-seated trauma, anxiety or unfulfilled childhood needs.

3. But not your passions

Still, that doesn't mean you shouldn't collect items you're passionate about. Los Angeles urologist William Sloan, 70, is a lifelong amateur violinist. During the 1980s Sloan bought a Stradivarius for $400,000 and a Guarneri del Gesù for $300,000, financing most of the purchases with high-interest (about 13%) loans from a Toledo bank. He paid off the loans within a decade, and today those rare instruments together are worth more than $12 million.

Sure, he could sell them and use the proceeds for retirement, but, he says, "they're like my family." (Never mind that Sloan is married with two adult daughters.) Anyway, he enjoys hobnobbing with concertmasters who borrow the violins and eight gold bows he's also amassed (total value: $750,000) for their performances. That's far more gratifying than investing in a blue-chip company, he says. "Do you invite people over for dinner to look at your stocks?"

4. Build intellectual capital

Become an expert or at least knowledgeable enough to distinguish the fabulous from the fake. Try to learn from a pro who has no financial stake in helping you—say, another collector rather than a dealer. (If you can't become an expert yourself, find one you trust to guide your purchases.)

Joseph H. Ellis, 70, a retired Goldman Sachs partner, started collecting miniature wood bird carvings in 1995, when four pintail ducks in a Cape Cod antiques shop caught his fancy. His collection has grown to several hundred carvings. In his New York City apartment dozens of ducks, shorebirds and more than 50 songbirds perch on open shelves, grouped by species. His most valuable carvings, including an Eskimo curlew (now extinct), sit in a glass case in the maid's room. Many more are on display at his home in Connecticut.

During the course of building his collection, Ellis realized there wasn't a comprehensive book on such carvings, so he wrote one, Birds in Wood and Paint (University Press of New England, 2009). During the three years it took to research and write his book, Ellis visited dealers, collectors and libraries along the East Coast; bought auction catalogs (he has three shelves of those) on eBay; used Excel spreadsheets to chart the number of birds each carver made; and (yes) bought more birds. Their value has fluctuated during the time he's

been collecting, roughly doubling until 2008 and declining by 25% to 50% since then, he says. Lately the birds have been fetching $1,000 to $1,500 apiece.

More important to Ellis is the information he has compiled for other collectors— -information that ultimately could increase interest in the field and prices. It's a history not just of the birds but also of the artists who created them, he says. "These are wood carvers whose lives deserved to get a little light." (See "10 Career Lessons From A Book About Bird Carvers.")

5. Know the tax rules

At any given time a collector may be a dealer, investor, business investor or hobbyist in the eyes of the Internal Revenue Service, says Matthew F. Erskine, a Worcester, Mass. lawyer who advises collectors. Each status has big tax consequences. For example, the hobbyist (which is what the IRS presumes you are unless you can show otherwise) gets taxed on his capital gains from selling collectibles at a 28% rate but can't deduct losses from sales or write off expenses such as insurance or repairs. An investor also gets taxed at 28% but can offset capital gains with losses (not just from the collectibles but from other investments, too) and can deduct expenses such as insurance as a miscellaneous, itemized deduction.

Continually buying and selling helps your argument that you are an investor rather than a hobbyist, Erskine says. Investors are also able to do what's called like-kind exchanges under Section 1031 of the tax code. This provision allows you to swap one asset for another and not pay tax on the gain until you finally cash out. The rules are tricky, though, so don't try this without professional help.

6. Donate items to a related group

As with publicly traded securities, there are tax incentives to make gifts to charity of property that has gone up in value, but they are more limited than with stock.

You can deduct the full fair-market value of an item at the time of a donation without ever recognizing or being taxed on the gain—but only if the charity uses the asset in a way that is related to its exempt purpose. Otherwise, your income tax deduction is limited to your basis in the asset (what it initially cost you) or its fair-market value, whichever is less.

Byers, for example, could deduct the full fair-market value when he donated some of his appreciated specimens to the California Academy of Sciences, because it is a natural history museum. (Make sure the charity doesn't plan to immediately sell your object or it could jeopardize your related-use deduction.)

7. Have a disaster plan

Chances are your homeowner's policy doesn't cover collectibles—you need a personal articles floater for that, says Laura Clark, senior underwriting manager at the Chubb Group of Insurance Cos. You have a choice between blanket coverage and listing every item. With blanket coverage you insure for a total—say $500,000—and choose a per-item limit (for example, $3,000 per carved bird) without telling your insurer precisely what you're insuring. That works well if there are frequent shifts in your collection, if you value your privacy or if you have more than one home (the coverage is worldwide). Itemized coverage generally costs the same per $1,000 of coverage, but you must list and describe each item when you buy the policy. To avoid disappointment at the time of loss, insure for the replacement value of each item, Clark suggests.

Sloan spends $12,500 per year for itemized coverage of his instruments and keeps them in a secret closet in his home with its own alarm. When fires are forecast in Los Angeles, he straps the violins in the backseat of his car and takes them to his office.

8. Leave heirs a road map

If you're getting on in years the tax law gives you a strong incentive to hold on to any collectibles that have appreciated in value. At your death the basis of your treasures is "stepped-up" to their current market value—meaning heirs can sell immediately without owing capital gains tax. Conversely, if an item is now worth less than you paid for it, sell it yourself, since you, but not your heirs, can claim a capital loss, provided you qualify as an investor.

Still, without guidance from you, heirs might have no idea what they've got and may end up unloading your treasures at fire-sale prices. So keep records of what everything is (including any proof of authenticity), what you estimate it is worth and why you bought it, if that is integral to its value. (For example, "This fits well in the evolution of Gibson guitars.") If possible, leave heirs the name of an expert, such as a museum curator who specializes in your area or a reputable dealer, who can help them to sell.

Some heirs, alas, are in for disappointment. Joseph Bein, whose Chicago firm, Bein & Fushi, is known for its world-class expertise in stringed instruments, says he gets many calls from inheritors who think they found a Stradivarius in a relative's attic. Most are reproductions.