Jargon buster: What are revenue reserves?

We run the rule over investment trusts' revenue reserves...

Update
13 February 2025

Analysts:

David Brenchley
david.b@keplerpartners.com

Our new jargon-busting series has covered some of the basics of investment trusts, such as dividend yields, which we covered last week. This week, we'll explore dividends further by explaining revenue reserves.

Many of the investments that you can buy have the ability to pay out dividends and investment trusts are no different in that regard, but they do have some handy advantages on the income front.

Take open-ended funds as an example. These funds must distribute all of the income that they receive from their underlying holdings out to their investors each year. Investment trusts can do this, but they don't have to. Trusts are only required to distribute a minimum of 85% of the income they receive to shareholders. The remaining 15% can be held back in 'reserve'.

What is the revenue reserve?

When times are good and dividends are easy to come by, an investment trust can hold back up to 15% of the natural income they receive in the form of dividends. If they choose to do this, they use it to top up their revenue reserves. The revenue reserve can then be drawn on when times aren't so good and dividend payments from their underlying holdings are lower than usual.

This is the reason why there are so many investment trust dividend heroes (we'll come onto this in a later jargon buster). Take Covid, for instance: companies across the world decided to cut, scrap or postpone their dividend payments because of either lost income or regulatory intervention. Thus, many open ended funds and investment trusts didn't receive enough revenue that year to pay the same level of dividends to shareholders as the year before.

However, some frugal investment trusts that had built up their revenue reserves, and were thus able to pay out what they lost in natural income from their reserves, and thereby either maintain their dividend, or even slightly grow it.

Mythbusting

There is one point that I want to make here that some might not realise: the revenue reserve is not a literal pot of cash sitting in the bank that an investment trust can dip into when needed; it is merely an accounting convention.

Instead of being a ring-fenced amount of money, the revenue reserve actually constitutes an otherwise indistinguishable part of a trust's assets, and is invested in whatever else the trust is invested in.

When the time comes for the trust to utilise a portion of its revenue reserve to top up its dividend, the manager must sell a portion of the trust's portfolio, equal to the amount of the reserves the trust wishes to pay out as a dividend to release the funds.

Board's decision

The point should also be made that all decisions relating to the dividend are made by the board of directors, not the investment manager. It is purely at the discretion of the board whether the trust fully distributes income or retains up to 15%, or whether revenue reserves are used to support a trust's dividend.

In many cases the dividend history of a trust represents the 'track record' of a board, and many are keen to maintain that track record if possible. Hence, the 19 investment trust dividend heroes, trusts that have increased their dividends for 20 consecutive years or more. Many of these will have used their revenue reserves to keep their impressive records going through periods such as the dotcom bust, the global financial crisis and the coronavirus pandemic.

What revenue reserves can tell you about an investment trust

If it's income you're looking for from your investment trust portfolio, it's worth familiarising yourself with the amount of revenue it has in reserve. The industry convention is to express revenue reserves as a multiple of the last year's full year dividend (see table below). If it's held back a healthy amount in previous years, then the chances are it will be able to maintain or potentially increase its dividend payments even when stock markets are crashing and dividends are falling. As with anything though, there are no guarantees.

You can find information on revenue reserves on the AIC's website. I'll leave you with a starter for 10: below is a list of investment trusts yielding more than 2.5% with the highest revenue reserve dividend cover.

Keeping It In Reserve

INVESTMENT TRUST	SECTOR	DIVIDEND YIELD (%)	DIVIDEND COVER (YEARS)
HICL Infrastructure	Infrastructure	7.16	11.56
Schroder Real Estate	Property – UK Commercial	6.54	6.61
Target Healthcare REIT	Property – UK Healthcare	6.78	3.53
Majedie Investments	Flexible Investment	3.07	2.85
Marwyn Value Investors	UK Smaller Companies	9.24	2.82
Aberforth Smaller Companies	UK Smaller Companies	3.53	2.52
Templeton Emerging Markets	Global Emerging Markets	2.92	2.5
Baillie Gifford UK Growth	UK All Companies	2.87	2.39
Lindsell Train	Global	6.06	2.26
UIL Limited	Flexible Investmen	6.93	2.04

Source: Association of Investment Companies

Disclaimer

Past performance is not a reliable indicator of future results. The value of investments can fall as well as rise and you may get back less than you invested when you decide to sell your investments. It is strongly recommended that if you are a private investor independent financial advice should be taken before making any investment or financial decision.

Kepler Partners is not authorised to make recommendations to retail clients. This report has been issued by Kepler Partners LLP, is based on factual information only, is solely for information purposes only and any views contained in it must not be construed as investment or tax advice or a recommendation to buy, sell or take any action in relation to any investment.

The information provided on this website is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation or which would subject Kepler Partners LLP to any registration requirement within such jurisdiction or country. In particular, this website is exclusively for non-US Persons. Persons who access this information are required to inform themselves and to comply with any such restrictions.

The information contained in this website is not intended to constitute, and should not be construed as, investment advice. No representation or warranty, express or implied, is given by any person as to the accuracy or completeness of the information and no responsibility or liability is accepted for the accuracy or sufficiency of any of the information, for any errors, omissions or misstatements, negligent or otherwise. Any views and opinions, whilst given in good faith, are subject to change without notice.

This is not an official confirmation of terms and is not a recommendation, offer or solicitation to buy or sell or take any action in relation to any investment mentioned herein. Any prices or quotations contained herein are indicative only.

Kepler Partners LLP (including its partners, employees and representatives) or a connected person may have positions in or options on the securities detailed in this report, and may buy, sell or offer to purchase or sell such securities from time to time, but will at all times be subject to restrictions imposed by the firm's internal rules. A copy of the firm's Conflict of Interest policy is available on request.

PLEASE SEE ALSO OUR TERMS AND CONDITIONS

Kepler Partners LLP is authorised and regulated by the Financial Conduct Authority (FRN 480590), registered in England and Wales at 70 Conduit Street, London W1S 2GF with registered number OC334771.