LEVERAGING ART COLLECTIONS AS COLLATERAL

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Published: DBA Headnotes – March 2018

Banking institutions in the United States are taking the lead internationally in offering art-secured lending services. Based on the Deloitte and ArtTactic Art & Finance Report for 2017, the art-secured lending market in the US grew 13.3% in 2017 and is estimated to continue to increase in 2018. I was able to speak with John Arena, Senior Vice President and subject matter expert for fine art in Bank of America's wealth management business, while writing this article who stated, "Bank of America is a premier lender in the art space and is able to unlock cash in art collections by taking a static asset (one which is aesthetic only), to a dynamic asset (aesthetic and now economic) so borrowers can take advantage of opportunities they have." Currently, Bank of America is a major lender in the art market with a multi-billion dollar loan portfolio.

With the art market on the rise, many collectors and investors are looking for alternatives to free up capital frozen in their art collection. Art-secured loans are commonly used to purchase additional works of art, or for investment in other ventures. If you have an art-savvy client interested in obtaining an art-secured loan, there are some unique issues you should discuss with him or her prior to entering into such a transaction. An art-secured loan requires more than a credit check.

Depending on the lending institution, your client may be required to relinquish physical possession of the collateral artwork to the lender during the term of the loan. Larger banks typically do not take possession of the borrower's artwork, but this is not always the case. Transferring possession of the collateral artwork to the lending institution may become problematic for clients who also want to enjoy the art themselves, or possibly lend such artwork to museums or galleries for public exhibition. Furthermore, if the leveraged piece is well-known, it could be embarrassing for clients to have to explain to their artsy friends why their Warhol, Picasso, or Monet is no longer hanging above the fireplace. If these issues affect your client, you may suggest that they work with a lender that allows the borrower to retain possession of the pledged artwork during the loan term.

If the lending institution permits their borrowers to loan the collateral artwork for public exhibitions during to the term of the loan, your client will likely need to disclose to any exhibiting museum or gallery that the artwork is pledged for a loan. Furthermore, the lending institution may request that each exhibiting museum or gallery execute agreements which discuss liability for insurance, shipping, default, damage, and other risks related to possessing the pledged artwork. If the borrower defaults on the loan during the exhibition, your client will want all the parties involved to allow the museum or gallery to continue to display the collateral artwork for the remaining exhibition term in order to avoid scandals and bad press.

An art-secured loan will also require the borrower to receive a new appraisal of the collateral artwork and updated appraisals during the loan term. The principal amount of the loan is typically calculated based on 40-60% of the lowest auction value of the artwork. Adjustments may be made to the principal loan amount depending on the increase or decrease in the auction value of the collateral, which can change rapidly. Your client may need to leverage several different types of works to allow for a more stable value of the collateral. What is popular in the art market this year may be worth substantially less next year.

Other important concerns with art-secured loans include title, provenance, and authenticity of artworks. Similar to other types of collateral for loans, the borrower will have to provide sufficient evidence to the lending institution that they own the artwork free and clear of all encumbrances, and that what they own is authentic. In the art world, title means the right to own a work of art, but this does not necessarily mean you have possession of the work. There are hundreds of thousands of works of art that have been purchased by collectors and museums in which they do not own the right, title, and interest due to various underlying issues such as fraudulent paperwork or, in the more sensational cases, Nazi war crimes. Prior to receiving an art-secured loan, the lending institution will require research into the provenance of the proposed collateral artwork. Provenance is a history of the physical possession of the work from the date the artist created it to the present. If a work of art was involved in a transaction during World War II in Europe, this is an indication that very thorough research must be done to make sure the work was not stolen by Nazis or otherwise the subject of illegal plunder. Many art sales are handled privately with undisclosed sellers, dealers, or consignors, so establishing provenance can be extremely difficult, and often may result in proving the negative without the aid of clear records.

Authentication is much easier to evidence if the artist is alive, and you can usually obtain a certificate of authenticity from the artist that will be provided to the lending institution. However, if the artist is dead, or otherwise unreachable or unhelpful, your client may need to obtain an opinion of authenticity either from the artist's estate or from an expert in authenticating art. Some estates (for example the estates of Keith Haring and Andy Warhol) refuse to authenticate artwork, requiring interested parties to employ the services of an authenticator.

Art-secured loans are predicted to increase in 2018, and offer collectors quick access to capital that may be tied up in artwork they do not wish to part ways with. Given the uniqueness of this type of asset, most banks are flexible in the amount of the loan, interest rates, and other loan terms. But there are also risks that are unique to this collateral, and may require the aid of specialized experts, analysts, and attorneys. If you have a client interested in leveraging their art collection or a portion thereof, the issues set forth in this article should be discussed before your client settles on this path, and certainly before they sign any documents.