The art of asset finance

There has been an explosion of activity in the market for art and collectables, including musical instruments, jewellery, classic cars and fine wine in recent years. Collectors are paying record sums and the market is more international than ever, with new players arriving from Asia, the Middle East, Russia and South America.

The increased value of art and collectables has increased demand for loans against these assets. Consequently, new lenders have entered the sector introducing tailored, innovative loan products to suit collectors' needs. A young, burgeoning and influential generation of collectors who understand how to maximise the value and liquidity of their assets has taken advantage of these loan opportunities.

Collectors use their art assets as collateral to raise funds for various reasons. Some may be using the loan for commercial purposes, such as financing a business or refinancing existing debt. Others may want to use the credit to expand their collection with new acquisitions, or to diversify their wealth. Asset rich but cash poor collectors may need to raise capital for personal reasons, such as a divorce or to pay taxes, or simply to supplement income for lifestyle.

Whatever the reason, it is clear that the perception of wealth managers, dealers and collectors has shifted. Collectables are no longer treated as investments of passion alone, but as instruments of finance. High net worth individuals are increasingly viewing their collectables as financial investments which they want to make the most out of, and with good reason. More and more data is available which has helped to create some transparency in the art market. For example, websites such as the Mei Moses World All Art Index have been established, which evaluate historical data to measure art as an investment and asset class. The results have been impressive; certain collectables are outperforming many of the more mainstream investments such as FTSE 100.

The success of the international art market, which totalled €47.4bn in 2013, has been particularly noteworthy. Certain genres have received unprecedented interest – for example, Christie's auction in May 2014 achieved $744m for contemporary and post-war artworks. In addition to sales, the value of art has continued to rise dramatically over the last 10 years and investors' willingness to purchase collectables seems unaffected by the challenging economic climate prevalent since 2008. In November 2014, art was described in the New York Times as "firmly planted alongside equities, bonds, commodities and real estate as an asset class".

This solid interest has encouraged lending. In 2012, Michael Plummer of Artvest Partners estimated that the size of the art financing market was in the range of $7bn and continually growing. More recently, insurance broker Robertson Taylor W&O Longreach estimated today's art lending market to be worth in the region of £6bn per annum, with the potential to reach £15-20bn per annum.

In terms of other collectables, Knight Frank's Luxury Investment Index reported classic cars as the biggest gainer over a 10 year period, with growth of 456 percent among nine categories of collectables including art, cars, Chinese ceramics, coins, jewellery, furniture, stamps, watches and wine. Coins and stamps have also grown considerably over the last 10 years, with total growth reported at 227 percent and 250 percent respectively. Interestingly, in Europe, wine is reported to be the favourite "investment of passion"; this is in contrast with jewellery in Asia, Africa, Latin America and Russia. In any case, given the increasing importance of this sector, it is unsurprising that shrewd collectors and dealers are leveraging their collectables to finance other activities. Banks are more willing to offer loan facilities against these assets because data is more readily available and it is more reliable, allowing for greater visibility over value.

Collateralised loans against art are specifically tailored to the client and the collateral. On the whole, they will be structured as a term loan, a revolving loan or a line of credit. A lender will usually lend up to 50 percent of the value of the collateral, generally set by the lender at the low auction estimate, although the loan-to-value ratio may be lower for assets that are considered higher risk. The rate of interest is typically variable and the borrower is charged a one-off facility fee of between 1 percent and 3 percent of the loan amount, as well as valuation fees, legal fees and other costs such as insurance and storage.

The loans are available primarily through three sources: banks, auction houses and specialist lenders.

Private banks such as Citi, Deutsche Bank, JP Morgan and US Trust offer loans against art to select clients with significant assets under management. Their motivation in providing this type of finance is to strengthen their relationship with their clients. They prefer to lend against fine art. They conduct a detailed assessment of the borrower's net worth. Loans are full recourse and the minimum loan amount is typically $5m. There are exceptions, however. Emigrant Bank Fine Art Finance (EBFAF) is a regulated institution but not a private bank. It does not manage clients' assets. It simply provides credit against art and collectables. It lends against all collecting categories with an established auction market including string instruments, books and manuscripts, classic cars and fine wine. Since 2012, EBFAF has expanded out of the US to offer art loans in Europe. The minimum loan amount is $1m and the period is normally between one and 15 years. This sets it apart from the other banks.

Auction houses provide financing by offering advances over auction proceeds to consignors who are in need of immediate funds. By making funds available they are able to attract property for sale. Auction houses will consider offering loans against all types of collectables with an established auction market. Occasionally, an auction house may offer a longer term loan against an asset that has not yet been consigned to them, although this is unlikely to be the case unless there is a prospect of sale in the future.

Finally, there are specialist, asset-based lenders offering loans against art. They take greater risks than the banks and charge higher rates. They typically conduct no or minimal due diligence on the finances of the borrower. They tend to lend lower amounts for shorter periods of time. Their offering can differ considerably, for example, Borro offers short term loans against art and collectables, they take possession of the assets, charges high rates and closes loan transactions fast. Right Capital operates a peer-to-peer loan model. It does not lend but sources lenders which it introduces to borrowers and it facilitates the transaction. Falcon Fine Art loans against fine art only, focusing on the high-net-worth community, and allowing borrowers to keep possession of the art.

Whichever source is used, it is clear that lending against collectable assets offers a pragmatic solution to collectors and dealers' need for liquidity. The rapid growth of this market, combined with collectors seeking a greater return from their assets, has provided significant impetus for lending against art assets. As a result, specialist loans are becoming more widely available and present an interesting opportunity for high net worth collectors and dealers going forward.

Pierre Valentin & Rose Guest

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