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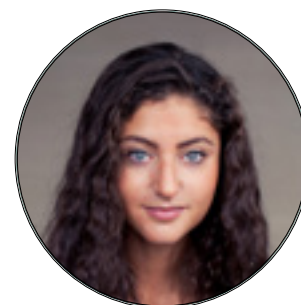
The Art of lending against artworks



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Art is a passion and a lifestyle for many collectors, but can be a highly capital-intensive pursuit for which few dedicated sources of financing exist. Increasingly, collectors and family offices are exploring asset-based lending against fine art as an integral and efficient way to finance their collections. This type of financing allows collectors to access credit secured purely by the value of their art and without encumbering other personal assets.

Since the financial crisis, traditional banks have largely retrenched from asset-based lending and certainly so against art. The few banks that do offer art lending typically also secure a collector's financial assets, resulting in far less flexibility for the collector. However, options for asset-based financing against art are growing and offer flexibility from multiple vantage points. Active collectors can seize on near-term acquisition opportunities while preserving their liquidity position and isolating the risk to their financial wealth. Family offices managing art as an investment can achieve superior financial leverage

against an appreciating asset, as well as the ability to re-allocate capital efficiently across an overall portfolio. Those with substantial collections, built over many decades or acquired through inheritance, can use an asset-based loan as an estate planning tool to manage a longer-term plan to sell, which could otherwise incur punitive and complex tax consequences.

Art-secured financing has existed in various forms, extending back to at least over a century when Paul Durand-Ruel, the pioneering French impressionist art dealer, collateralized his inventory to support his business. Today, however, both cyclical and structural trends underway in the current art market are accelerating the adoption of art-based financing as a standardised market tool. Weak auction sales results (down nearly 20% year-to-date) are raising interest in financing as an alternative channel to monetize a valued collection while retaining the option to sell in future.

At the same time, the overall increase in art valuation experienced over the past decade is necessitating greater

due diligence on the part of buyers, which ultimately helps to support the underwriting process required for an asset-based loan. However, many collectors remain unfamiliar with the basic requirements for an art-based loan. Broadly speaking, the asset-based nature of the loan shifts the underwriting focus to the art as collateral, both the objects themselves and their ownership structure.

Works by artists with a global collector base and an existing history at auction most readily serve as loan collateral. Collateral valuations are conservative estimates that would generate broad demand at auction. Advance rates (or loan-to-value or LTV) typically range up to 50% based on a diversified collection. Storage requirements can vary by jurisdiction, but with many collectors holding their art for investment purposes, holding art in specialised fine art storage facilities or free ports is increasingly commonplace.

In many respects, underwriting for an art-based loan begins with the due

diligence undertaken by a collector at acquisition and the adherence to best practices when managing a collection over time. Also, clarifying – in a purchase agreement – some legal considerations, such as legal title, export restrictions and applicable law, greatly help to ensure that an art collection may be considered for a loan.

The underwriting process typically involves review of the extent to which an art collector has addressed the following issues, many of which pertain to the future salability of the artwork by the collector:

- Provenance research: it is of utmost importance to verify the chain of title and that an artwork was not stolen or looted. This minimises the potential for a latent claim by a rightful owner or heirs, which could result in the collector being compelled to reconstitute the artwork. Collectors should be in possession of documents evidencing titles, such as past bills of sale or inheritance documentation.

Databases such as the German Lost Art Foundation Database, the Art Loss Register, the Central Registry of Information on Looted Cultural Property 1933-1945, the Descriptive Catalogue of Looted Judaica or the Getty Provenance Index databases and other governmental and non-governmental databases (i.e. Interpol) also aid as sources for provenance information;

- In the event of a cultural good: collectors must ensure that an artwork falling under the definition of a cultural good was not acquired in breach of cultural goods protection laws, including cases in which a work may have been exported illegally from its country of origin, which could also lead potentially to a claim for restitution;

- Expert analysis: collectors should have appropriate experts evaluate the artwork for any potential issues related to authenticity and physical condition. This includes reviews of the respective catalogue raisonné, exhibition history, treatment in literature by leading scholars, authenticity certificates (where applicable) and inspection of the physical condition of the work. Collectors increasingly use technical, physical analysis as well;

- Intellectual property rights: the intellectual property rights of the artist must not be violated, and collectors must, in particular, ensure that they are free to transfer the artwork or that any artist resale rights have been complied with;

- Insurance: adequate insurance underwritten by a highly-rated carrier is critical to the protection of the artwork against physical risks related to damage and theft. The value set for the insurance must be carefully reviewed, as it may also be relevant for tax purposes;

- Customs and taxes: customs duties and taxes must be carefully assessed and complied with to avoid any outstanding liability that may reduce the liquidity for an artwork and prevent or limit its future transfer. Certain customs fees and taxes may be minimised depending on the applicable law of the collector's estate, the physical location of the artwork or the use of a legal vehicle, such as a company, a trust or a foundation;

- Wealth transfer issues: Building a collection is a lifelong endeavour – often even multigenerational –, and asset-based lending can be an integral part of a collector's estate planning strategy. Without adequate estate planning, however, the value of a collection can be quickly

diminished. Dissension among heirs or neglected tax payments could result in a collection being divided and reduced in value. Therefore, collectors must clarify the law(s) which applies to their estate, as this has implications for issues such as heirship rules, tax on the estate and for the heirs of the estate, the handling of debts of the estate and remedies available to the heirs. The estate planning strategy should also address the particularities related to the chosen matrimonial regime as this could have an important impact in case of death or divorce.

In general, better-documented collections provide for a faster overall process of securing a loan against the art. Professionally managed and documented collections can facilitate processing of an art-based loan in a matter of weeks.

Whether to support new acquisitions or simply to enhance the liquidity of a valuable asset, asset-based loans against art can assist collectors and family offices in a wide range of circumstances, without the need to sell. However, this requires diligence and prudent planning. Collectors are strongly advised to seek professional guidance to ensure that an artwork's artistic and financial potential are best preserved.

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