WealthBriefing

Bringing Merchant Banking Mentality To Fine Art

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A business formed by a Swiss private bank and major private equity house says it aims to change how the art market functions.

For decades the international art market, while glamorous to the uninitiated, has also often been opaque and relatively awkward in terms of price information and analysis. The internet has started to shake things up – with such futuristic technology like blockchain.

About two-and-a-half years ago, Athena Art Finance entered the field with a brief to inject some investment banking and tech savvy into the space. Backed by Swiss private bank Pictet and the US private equity titan Carlyle Group, the New York-based firm says business is brisk, although growing in ways that had not always been expected in its original plans. Since 2015 when it was founded, Athena has provided over $170 million in art-secured financing.

With the circuit of Art Basel and other summer season art events coming around thick and fast, and art market stories continuing to make the front pages at times, there is plenty of work for Athena to do, its chief executive and founder, Andrea Danese, told this publication.

"When we started, we thought the core of the business would be working with individual collectors. Now, about 50 per cent of work is with art dealers, 25 per cent is with individuals and the rest is with auction houses and trusts/estates," he said. Asked why the business volumes had split this way, Danese said the firm realised that with many dealers, their lumpy cash-flows and asset/liability mismatches meant banks did not like doing business with them – creating a gap for Athena to fill. And one big gap is data.

Enabling dealers and other practitioners to unlock the value of collateral by careful analysis of art trends, including via sophisticated quantitative methods, is part of the "secret sauce" of this business. Danese himself brings some of the sensibility of Wall Street to the job. He worked in investment banking for more than 20 years, toiling at JP Morgan and Deutsche Bank. During some of this time he worked in the credit derivatives market; in 2000 he co-founded Creditex, a credit derivatives trading platform, and then he went to work for financial news and data firm Bloomberg on the financial market data side, before leaving in 2014.

Since its launch, Athena has grown to employ 13 people and is now making a profit (it does not disclose specific numbers). Danese said the organisation wants to boost its lending volumes and develop more around the research and art solutions side as well.

"I want Athena to be a merchant bank for the art market," he said. "This is a market very much in its infancy," he said.

Case studies

Explaining its approach, Athena described how it lent $3 million to a private collector secured by an existing collection that had been built over many decades. The private collector was seeking additional investment capital to reinvest into private companies and VC investments. In this case, it also provided a three-year loan and the client retained possession of the collection all at their residence, using the funding Athena provided to supplement the collector's existing financial resources and make the investments they wished to make.

In another case, it provided a $5 million loan with a three-year term to a different private collector to support the acquisition of several additional pieces to the client's collection. The client was making a long-term investment, and the loan was financially efficient enough for the collector to make the acquisitions, and keep capital in other business ventures.

In a third example, Athena provided a three-year $7 million facility to an active art dealer secured by its existing inventory. The financing freed up working and investment capital for the dealer to make new acquisitions. In all cases, the loans were based on the London Interbank Offered Rate (LIBOR), with spreads generally in the 6-7n per cent range — mid to high single digits, the firm told this publication.

Ups and downs

The global art market put on stronger figures in 2017 after having endured two successive down years, according to the Art Basel and UBS Global Art Market Report published in March this year. Total sales of an estimated $63.7 billion were recorded in 2017, a 12 per cent increase from 2016. That report also noted that much of the uplift in sales in the auction and dealer sectors was at the top end of the market, capped by record prices in the auction sector, including the sale of the Leonardo da Vinci painting Salvator Mundi for $450 million at the UK auction house Christie's. The US was the largest market worldwide, accounting for 42 per cent of sales by value, with China in second place at 21 per cent, and the UK the third largest market with 20 per cent. The Asian market accounted for 23 per cent of global sales in 2017, and Asian buyers accounted for 15 per cent of dealer sales globally, with Chinese buyers representing the majority at 10 per cent, up significantly from just four per cent in 2016. The online art market increased substantially in size over the last five years by 72 per cent, reaching an estimated $5.4 billion in 2017. As the figures show, internet-based sales still only account for a slice of the total, showing that face-to-face contact is still the name of the game in some segments.

Athena's Danese said that he and colleagues have devoted much of the past two years to assembling a database of art sales, transactions and trends: "That gives us comfort that we have coverage of the top 500 artists in the market." Athena is building its own art market scoring mechanism, so that it can assess qualities such as the liquidity and sellability of a work of art, and attach a level of risk to a work in digestible ways. Such an approach is also useful in educating consumers around such qualities, he continued. Athena also takes care of checking provenance, due diligence on a seller, and conservation of the pieces.

A rich mass of data gives the firm comfort in knowing the artworks that it would be willing to lend against – and raise any red flags where there might be an issue, he said.

Talk of merchant banking and art is not new. Besides Athena, another firm in the space, for example, is Falcon Fine Art, launched in 2014. Citi Private Bank has a notable art advisory arm; and UBS has offered lending against art, to give another example.

As reported by this publication two years ago, a report by Deloitte and ArtTactic on the US market pegged the art-lending market between $15 billion and $19 billion. Private banks had, as reported then, an estimated loan book size of between $13 billion and $15 billion. Deloitte and ArtTactic report warned that: "We are seeing a marginally overheated market: a number of factors have been driving inflation in the art market, from the growth in global wealth to the cheap and easily accessible liquidity providing the means."

New players in the art lending market, who are often dubbed asset-based lenders, offering non-recourse lending, can't claim on any of the client's other assets. Because this is a higher risk loan, it will typically incur a higher interest rate, as the work of art acts as the only source of collateral for the loan.

An issue when the subject of asset-based lending comes up is how well the industry can ride out a recession or economic shock. The art market is not immune to wider economic trends or changing interest rates and financial market liquidity. The past decade, fuelled by central bank quantitative easing (translation: printing money), has seen a substantial rise in asset prices, including - with some caveats - the art market. The question arises when, if not if, black clouds will arrive over the horizon.

It would be impossible to discuss innovation in this case without mentioning technologies such as blockchain. For example, as reported in May last year, art investors, collectors and owners were able to trade shares in fine art through a new platform powered by blockchain technology (the distributed ledger system associated most commonly with bitcoin). Maecenas says it wants to shake up the $56 billion industry with its new platform that matches art owners with investors, while the blockchain technology underpinning transactions will create a fairer and more open market, reduce costs and increase transparency. Willstone Management, a London-based art investment company, and Willstone Capital, its art finance division, which lends against art guarantees placed with major auction houses, also took the crypto-currency plunge by receiving payments in Bitcoin for major transactions.

Controls

An important issue for art-based lending is being sure what's legitimate and what's fake. A shocking story a few weeks ago from the Terrus Museum in Elne, France, showed that 82 of the 140 works displayed were worthless fakes. Forgery isn't the only problem. Another is art being used to launder money. Laws are tightening, however. In April this year, the European Parliament adopted the fifth Anti-Money-Laundering directive, which turned screws on illicit money in the art market. The new rules, taking effect in 2019, cover all businesses selling works of art with transactions of €10,000 ($11,670) or more, regardless of whether in cash or credit cards, bank transfers, etc, and lower-value amounts that add up to €10,000 are also covered.

While compliance burdens can cause some to complain, Athena's Danese said he is pleased that authorities are tough. With about 40 per cent of the global art market being bought and sold via auctions, this means that more than half the sales are private transactions, making the need for more controls and disclosure important. Greater controls bring more confidence into the market – clearly a positive step, he said.

"The regulators are giving more attention to all this and this is good from our perspective ... in fact it should draw in more participants," he said.