Eight questions to ask if you're thinking of an art loan

Published on December 8, 2015

Denis Petkovic

Borrowing money against your collection of artworks is an attractive - if complicated - option. Here are Denis Petkovic's tips.

Despite the last global financial crisis, the art market has continued to perform well and many families have seen the value of their collections jump to become an increasingly important share of their wealth. As more families are looking at ways to 'cash out' and 'monetise' their collections, the number of loans secured by art is on the rise both in Asia and in more mature art markets such as the USA. This has led to an influx of new specialist 'art lenders' (and even hedge fund lenders), in addition to more traditional lenders such as banks and auction houses.

Though it could be a smart move to use the family art collection as security for a loan, one needs to tread carefully, in particular, as the new breed of art lenders tend to offer more expensive loans than traditional lenders. Below are outlined eight points to keep in mind when considering taking a loan with the family art collection as security.

1. What do you want?

It is important to identify clearly the nature of the loan, and what the family and lender seek to achieve from the transaction.

The art lending market now has a mix of lenders with different outlooks and loan products. For example, bank lenders and even the auction houses tend to see art finance as a sideline to other 'strategic business' associated with a family or as a segue into a new strategic relationship. Some private banks will only engage in such lending if wealth management business is also provided to the family.

This in contrast to some new art lending specialists who, generally, see art finance as 'core' business in its own right and can be prepared to rely on the artwork as their only avenue of enforcement or repayment rather than imposing personal liability on family members.

Such specialist art lenders can charge a much higher rate of interest than other lenders. During the last financial crisis, some New York art lenders were, reportedly, charging interest between 18 to 24 per cent per annum and even nowadays interest rates of 9 to 15 per cent are advertised in this segment of the market.

2. Can you afford it?

Unless the loan is intended to be exclusively repaid from the artwork rather than from family members personally, a lender will need to assess the family's ability to repay the loan and have regard to the family business, income and track record before making a loan.

Many borrowers are borrowing against their art with a view to managing their assets to achieve a higher return above their funding costs. Scheduled principal and interest payments must be met from the cash flow of borrowing family members. On-going financial requirements set by the lender will regularly require updated valuations of the art and checks on the health of the family business (with the loan repaid in whole or part if value falls).

3. How much is it worth?

A valuation of the art will be needed. The lender will only be prepared to finance a percentage of the work's appraised 'fair market value'. This is usually between 40-60 per cent (and commonly 50 per cent) of such value.

4. What kind of security is it?

The form of security will typically be a mortgage (from a company) or pledge (from an individual) under which the work will be secured to the lender. It is more straightforward to create security in England and Hong Kong over art that is owned by a company than an individual and some lenders may prefer for a family first to transfer ownership into a company. The lender will have a right to sell the art at times of default.

5. Do you need to hand it over?

The lender is also likely to insist upon delivery of possession of the artwork to itself or a third party storage company who will hold the work for the benefit of or to the lender's order. Letting the artwork hang on the family's walls is generally not an option for art lending under English or Hong Kong law (although it is more common in the USA).

This delivery step, including 'constructive delivery' to the lender via a storage company, which holds the artwork for the lender, strengthens the lender's security position at law. A feature of transactions involving China is that some foreign lenders will not lend against art located in China even if the relevant borrower is not located there unless the artwork is moved to another jurisdiction owing to enforcement concerns. This may be a relevant consideration given current upheaval in the Chinese financial markets.

6. Can you prove you own it?

Evidence of ownership by the family will need to be provided and proof of the artwork's provenance or history. This is to guard against adverse interests which might predate and trump the lender's security position and to minimise the risk of the artwork being a fake or inauthentic.

7. Is it insured?

The artwork will also need to be insured by the family members with the insurance policy assigned to the lender and the lender named as the loss payee under the policy to cover loss from theft or damage.

8. Do you really want to do this?

Where the artwork is or was a marital asset, there will need to be independent legal advice taken by each of the couple so as to ensure that neither is exercising undue influence over the other and that the lender is not exercising undue influence over either of them or any guarantor.

Lawyers for the lender must be different from the lawyers for the couple and any guarantor and the loan documents should not, for example, be signed at the lender's office unless the borrower or any guarantor are represented at the signing by their own legal counsel.

The pricing of art lending can, in some segments of the market, be expensive and the ability of a family to raise cash is limited to about half the fair market value of the art. However the diversity and maturity of the art finance market shows that borrowing is not a reflection of a family's financial distress (or the equivalent of selling off the family silver) but may be a good financial strategy to monetise a valuable asset.

This article was originally published by Spear's (www.spearswms.com) on 22 September 2015.