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MARKET INSIGHT

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ART LENDING

In recent years, the high-end art market has shown its dynamism, with growth in both the number of transactions and from a valuation perspective. What's clear is that the global demand for art is continually rising.

While fervent collectors, fashionistas, and other trend setters remain an active part of the market, art is also increasingly seen as a pure investment play by multiple types of investors, with some observers now classifying art as an asset class in itself. Of course, this is a debated question, particularly between purists and financiers, but the consideration of art as an investment has expanded greatly due to the larger drive for portfolio diversification. In addition, the investment performance of art, like other alternative asset classes, typically does not correlate with more traditional asset classes such as equities or bonds. Overall, those who have invested in art, or indeed in classic cars or classic watches, have benefited from favorable market trends in recent years.

Until recently, individuals or families have mainly been investing by directly purchasing art pieces for their investment value, thereby creating a need for a more sophisticated approach to managing art-related wealth. As a result, many new art players and investment products are emerging to address clients' needs for dedicated solutions in the art space.

A new offering, art lending, is also gaining momentum, offering investors a fixed income instrument backed by artworks. This product is rather well-developed in the US, with a market worth estimated to be USD19 billion, but is still considered to be fairly new in Europe. This is surprising given that it is the largest art market in the world in terms of sales made through auctions, private sales and dealers. This highlights the significant potential that could be derived by expanding art lending, which has yet to become well-known among European art collectors. New initiatives have been seen recently from actors seeking to seize this opportunity to develop this service into the European market.

The practice of art lending on a high level basis is fairly simple: art borrowers receive cash based on the value of their art piece(s) that they pledge as collateral. The financing provided to the borrower is therefore based, in whole or in part, on the estimated value of the artwork which itself is dependent on the artist and the art market. In case of a default, the lender can take possession of the collateral artwork and sell it to reimburse the outstanding amount under the loan.

This product is an attractive alternative to selling the artwork as it involves no significant transaction costs, nor taxes on capital gains while it allows the collector to continue owning the art piece. It also avoids some potential pitfalls in selling a high-value asset through an auction house which could attract attention and raise questions about the seller's financial stability.

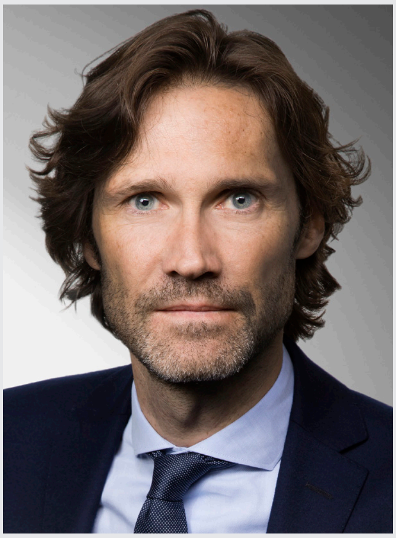
The art lending market has primarily developed through the financial services offerings of auction houses and banks. Auction houses, however, often use their art finance capabilities as a way to win consignments, the loans that they offer are generally offered on the basis that borrowers buy or sell art through them. Various European banks also provide art lending solutions, but they do so primarily for their own clients (i.e. who have assets deposited with them); this allows them to offset any potential defaults with the clients' entire portfolio. These products are not true art-secured loans and interest rates do not reflect the real risk profile of the art pieces granted as collateral.

Ultimately, only a handful number of lenders provide art financing (i) based solely on the value of the art piece(s), and (ii) with a total freedom on the use of proceeds. In these so called non-recourse loans, only art serves as a collateral. As this type of loan relies entirely on the art piece, it is important for those providing loans to partner with experienced art advisors or have in-house art capabilities. Indeed, despite the growing art market trend, there are multiple challenges remaining when dealing with art. For example the lack of transparency can make collectors apprehensive about art trades, while other issues around ownership, liquidity, and forgery have become more and more apparent. It is therefore critical for market players who want to succeed in art lending to be able to perform thorough valuations and due diligence analysis.

In the end, borrowers choose their art financing solution based on their financial situation and intended use of proceeds. Loans can be structured with short or long term maturity, low or high loan-to-value, amortizing or bullet repayment, or as already mentioned, with a recourse or non-recourse feature. This range of terms allows lenders to grant loans with interest rates that can widely vary from 2.5 - 3% per annum for recourse loans, to as high as double digits figures for loans provided by pawn brokers. In order to refinance their loans, some institutions place art-backed securities in the market, allowing individuals, family offices, or other asset managers to indirectly invest in art while receiving a profitable return.

In this case, loans which are themselves directly backed by art collections are securitized through segregated, bankruptcy remote vehicles. The art-backed notes are issued with an international ISIN code and are exchanged through clearing houses in order to allow investors to easily subscribe to part or all of the note issuance. This effectively creates a market where art investors and art collectors' interests can be met: these securitization platforms structure art-backed financial instruments that benefit both borrowers and all types of small or large investors. These investors are attracted by the exposure they have to the artworks only, as they face a risk/return directly linked to the art collections on which the underlying loans are based.

While asset-backed securities have usually been structured by collateralizing assets such as loans, leases, receivables or credit card debts, securitizing non-recourse art loans is indeed an innovative offering which could be a game changer for the development of the art lending market in Europe.



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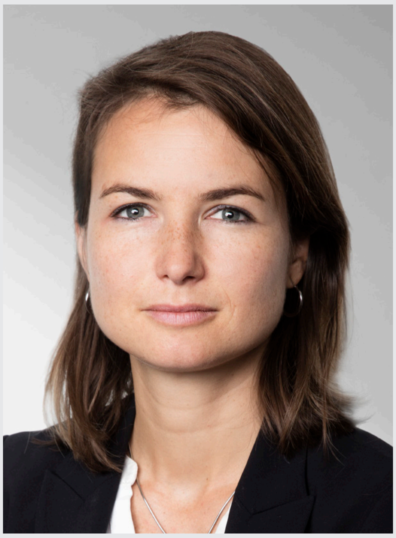

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