A Safe Haven: Art Lending

By Alan Snyder and David Toma

As we continue to meet the challenges of the coronavirus pandemic, several recent art market research reports provide some illumination into the art market's resurgence in 2021, highlighting the continued attractiveness, durability, and opportunity for lending against this hard asset that enjoys global appeal.

Deloitte Private and ArtTactic's "Art & Finance Report 2021" corroborates our own enthusiasm. Using the three major auction houses of Sotheby's, Christie's, and Phillips as a bellwether, global art market activity is roaring back to life after a period of recovery throughout 2020. Riding the wave of momentum generated by a 30% increase in global auctions sales to close out the second half of last year, these institutions saw a return to pre-pandemic levels of $5.9 billion in just the first six months of 2021.

Is this gravity-defying 230% year-on-year rise witnessed by the major auction players only a rogue wave? The data suggests otherwise. An increased fervor at the auction block, bolstered by exciting new offerings and innovative hybrid formats, closes out the year and sets the stage for 2022, with Sotheby's posting the most valuable sale in its history this November in the highly anticipated Macklowe Collection, which pulled in over half a billion in sales.

With eager collectors catapulting premiere auction events to all-time records, sell-through rates hovering at or near 100%, and online sales doubling in turnover, there is much to be positive about; but, how does art compare? Two of the strongest categories since the pandemic began are Post War and Contemporary Art. Both have consistently and aggressively outperformed the S&P 500, a trend that can be traced back to 2009. The Index for Global Post-War Art provided by Artnet (a premier online art market and intelligence provider), expanded by 38% in the first half of 2021, reaching a 20-year peak.

Unquestionably, art continues to prove its worth. But, where does the confidence in our fund originate? The Art & Finance Report offers clues to the advantages provided by asset-based lenders during this resurgence in the art market. Keeping in mind our strategic status quo: we lend against museum-quality art with our current results delivering an average portfolio duration of five months, loan-to-value ratio of 40%, a net investor yield of approximately 7% (unlevered) and the collateral under our control. Stand-alone sidecars offer higher yields albeit with less diversification.

The report's survey of collectors, who were rated this year as the most important client demographic among wealth managers, reveals that COVID-19 actually increased their interest in art-secured lending. As the broader market reeled from the shockwave of shutdowns, panic and inflation, many realized the potential of their art assets as a reserve of untapped equity. Art Basel and UBS's "The Art Market 2021" (prepared by Clare McAndrew) also echoed this sentiment: 66% of 2,569 high-net-worth collectors surveyed reported an increase in their art-collecting interest specifically due to the aforementioned circumstances.

Art-secured financing allows these collectors to participate in the market while retaining ownership of their assets and unlock capital for other endeavors. These points continue to be the main drivers in the lending market today and were proven particularly relevant during the worst of the pandemic, where many sought to weather the storm.

As art market players seek to capitalize on their sources of liquidity, significant differences in growth rates between private banks and asset-based art lenders arise. Whilst private banks reported an average growth rate of 5% in 2020, asset-based lenders observed an average growth of 21%.

Contemporary and Ultra-Contemporary collectors swept up in the tides of the surging art market are less likely to have ample capital, other sizable assets, or an impressive enough art collection to catch the eye of larger banking institutions. However, these collectors can immediately seek liquidity through experienced specialty lenders in the space to help grow their collection or diversify their portfolio.

A rising tide lifts all boats, and in a rejuvenated art market, lenders have much to look forward to. Deloitte Private and ArtTactic's report estimates that the overall market size of outstanding loans against art could attain a 10.7% average growth rate in 2021, and a roughly 20% increase from 2021 to 2022 in the total art loan portfolio size for asset-based lenders.

In addition to the benefits drawn from collectors, the dealer channel remains an important relationship for us, with a strong attachment point. If there were to be an unscrupulous act by a dealer, his or her reputation and entire business would be at risk.

Another plus for us is that higher-end galleries and dealers seek external inventory financing even as their overall debt levels remain modest. As Clare McAndrew's report corroborates, nearly half of the dealers surveyed by Art Basel accessed loans for their business over 2020. Even further, there is a stead-fast optimism with 65% of these high-end dealers expecting an increase in sales throughout 2021.

The coronavirus has certainly left much in its wake, but we are here to ride the wave. A revitalized market with a full-spectrum return to pre-pandemic levels creates an attractive lending opportunity for our Art Lending Fund and sidecar investors.