Creative Collateral: Lending Against Fine Art

March 22, 2018
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I. Abstract

Art-secured lending is a creative twist on traditional forms of asset-based lending, rewarding investors willing to investigate the space with compelling yields and secure collateral. This paper examines the various issues investors must consider before accepting fine art as loan collateral. Beginning with the factors that drive demand for art-secured lending, the different types of loans available to potential borrowers, and an analysis of the current market, we lay out the risks, including liquidity, valuation, provenance, and security of the art, both in the physical and legal sense. In addition, we provide methods and strategies that can be used to safely navigate these risks. With the proper risk management in place, art-secured lending can generate attractive returns (8% - 12%) for an investor while providing the security associated with traditional asset-based lending.

II. Introduction

Art has long been considered a passion investment. Wealthy collectors dedicate their time and fortunes to amassing paintings from particular artists or movements. J. Paul Getty, oil magnate and founder of the Getty Museum, fit this mold. He spent millions purchasing paintings for his collection, but he was not as liberal with his wealth in other areas. He famously installed a payphone in his house so that his guests did not run up his telephone bill with long distance phone calls. When his grandson was kidnapped, Getty refused to pay the initial $17 million ransom, and only after a severed ear arrived in the mail did he agree to pay $2.2 million, $800,000 of which was a loan to his son at 4% interest.[1,2] While art is traditionally viewed as a luxury afforded by individuals such as Getty, the stable and often increasing value of many works makes high-end art an appealing choice as loan collateral.

Individual works of art can be illiquid and difficult to value. The market lacks transparency, leaving casual art purchasers exposed to such risks. Yet, fine art is truly an international asset with its collateral value commensurately increased as a result, notwithstanding the traditional caveats. Highlighting this consideration, one can sell a Picasso in New York, London, Tokyo, or Timbuktu to take advantage of currency fluctuations and to provide an attractive counterbalance to fixed location assets such as real estate.

Instead of purchasing a work of art outright, however, an interested investor can choose to extend a loan with fine art as collateral. Lending against fine art, with appropriate due diligence and risk mitigants in place, can offer investors an attractive return, short duration, and multiple layers of security.

III. Demand for Art-Secured Lending

Understanding the characteristics of a potential borrower and their motivations for taking out a loan enables the lender to ensure that all parties' interests are aligned for the term of the loan. Demand for art-secured lending is driven by collectors and dealers looking to access the value of

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[1] Waxman, Olivia B. "The True Story of the Kidnapping Behind 'All the Money in the World.'"
[2] Thompson, Erin. "What Drives Art Collectors to Buy and Display Their Finds?" – Erin Thompson | Aeon Essays.

their art collections without selling any of the individual pieces. An art dealer or collector might want to fund further art acquisitions, finance inventory, or pursue other business opportunities. Selling the art to access the cash value is frequently a less attractive option, as there are many headaches for the seller throughout the sales process. Auctions may be a slow process because one might have to wait for an auction relevant to the genre being sold. Auction houses, art dealers, and galleries charge high selling fees, which may be negotiable. Typically, the buyer's fee is non-negotiable. Additionally, a capital gains tax would apply to the sale, plus potential state and local taxes.[3] Finally, because art is often both a passion and an investment, owners can be reluctant to sell. Borrowing against art allows the owner to avoid taxes, transaction costs, and the time associated with a sale, all while maintaining ownership of the art and any potential price appreciation.

IV. Types of Art-Secured Lending

There are two main types of art-secured lending: non-recourse and recourse.[4] With a non-recourse loan, the lender can sell the art used as collateral if the borrower defaults, but cannot pursue additional compensation from the borrower if the proceeds of sale of the collateral does not completely cover the amount owed. With a recourse loan, if the proceeds from the sale do not cover the total debt owed to the lender, the borrower must pay the lender any remaining amounts owed. Because non-recourse loans are riskier for the lender than recourse loans, higher rates are charged for such loans.

V. Market

Deloitte estimates that the value of outstanding art-secured loans was between $15 billion and $19 billion in 2016. Private banks serve the largest portion of the market, with approximately $13 billion to $15 billion of loans outstanding. Typically these loans have very low rates, ranging from 1% to 3%, but may require additional collateral such as a portfolio of securities.[5] Auction houses originate art-secured loans as well. They currently hold between $1 billion and $1.4 billion of outstanding loans with rates between 5% and 7%. Boutique lenders are not far behind auction houses, with outstanding loan value somewhere between $700 million and $1.2 billion. Boutique lenders offer more flexibility in loan structuring and size. As a result, interest rates range from 7% to 15%.[4] The art-secured lending market in the U.S. has grown significantly over the past five years. Private banks and boutique lenders report annual growth rates of 13% to 15% and auction-house lending operations have grown 30% annually over the same timeframe.[4] With new data for 2017, Deloitte estimates the value of loans outstanding grew to $17 - $20 billion, a 13.3% increase over the previous year.[6]

As the art-secured lending market has expanded, perception of the risks associated with the practice has shifted. In a 2016 survey by ArtTactic and Deloitte, 75% of participants (126 art

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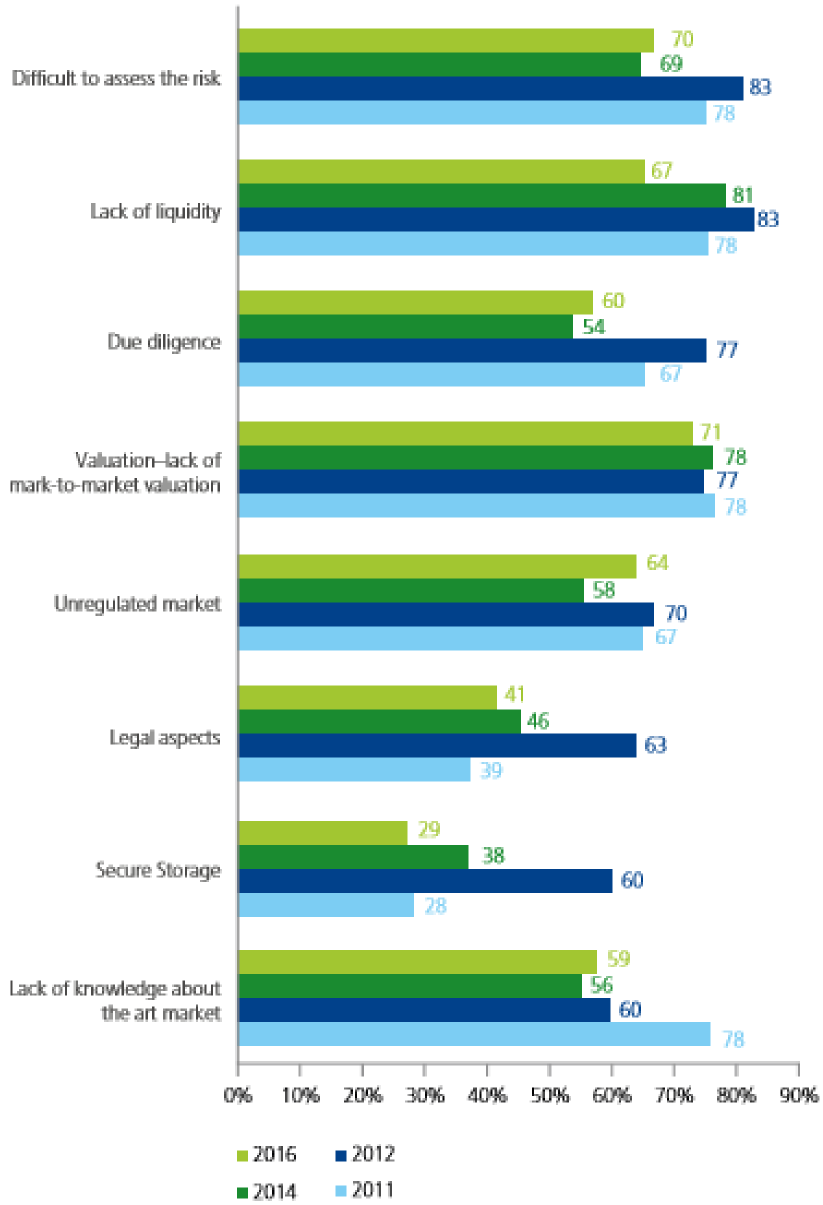
[3] Katz, Alan E. "Borrowing with Art as Collateral."
[4] Deloitte Touche Tohmatsu Limited, and ArtTactic. "Art & Finance Report 2016."
[5] Tully, Kathryn. "How Easy Is It To Get An Art-Backed Loan?"
[6] Deloitte Touche Tohmatsu Limited, and ArtTactic. "Art & Finance Report 2017."

professionals and 94 “important art collectors”) claimed authenticity, lack of provenance, forgery, and attribution (i.e. determining the artist responsible) were the most important factors affecting credibility and trust in the art market.[4] Participants in the survey gave responses based on the question: “What do you feel is the main hurdle for providing art-secured lending/art as collateral to the bank’s current clients?”[4] The graphic below shows how the perception of each risk has shifted during the years this survey was given.

Perception of Risks Surrounding Art-Secured Lending



Source: Deloitte Luxembourg & ArtTactic Art & Finance Report 2016

The majority of participants remain concerned with art-specific valuation challenges and the difficulty of accurately assessing risks in general. While liquidity is still considered one of the more challenging issues to navigate, it is no longer viewed as the main deterrent to accepting art as loan collateral.[4]

VI. Liquidity

Similar to real estate and collectibles, art is relatively illiquid when compared to traditional investments such as stocks and bonds. The demand for a particular work of art drives the liquidity, as there are a limited number of potential buyers for any high-end piece. As a lender, it is important to consider the liquidity of the art market segment, other works by the same artist, and the individual piece of art. Relatively liquid collateral can be sold more quickly if the borrower defaults, decreasing the risk that the value will drop during the time it takes to make a sale. If the lender is stuck holding onto the art longer than the intended duration of the loan, the rate of return could decrease even if the artwork is sold close to its original appraised value. A low "loan-to-value" ratio gives the lender a buffer against extended transaction times in such an event of default.

Although art as a whole is considered an illiquid asset, the liquidity of an individual work of art varies by artist and by movement or genre. Recent auction sales data can illustrate how the liquidity of works by one artist compares to the liquidity of works by his or her peers, or how demand in a certain movement/genre compares to demand in another. Looking deeper, higher sales volume might simply indicate that a particular artist produced more works than his or her peers or that a movement encompasses more artists or a longer time period.

The percentage of works "bought-in" by the auction house gives a stronger indication of the level of demand for comparable pieces. A work of art is "bought-in" when the minimum sale price is not met and the work goes unsold. A low bought-in rate for an artist (or movement/genre) indicates that his or her works are in relatively high demand, driving the price at auction above the minimum and resulting in a sale.[7] A high bought-in rate suggests works by that artist are not easy to sell. Lending against fine art produced by an in-demand artist or from a popular genre gives the lender collateral with relative liquidity, facilitating a quick sale in the event of default.

VII. Valuation

Accurate valuation of the art to be used as collateral is a critical factor to consider when evaluating a potential loan. The valuation represents the closest approximation of the potential sale price of the work. If the borrower defaults, ideally the lender can recover the full amount owed through the proceeds from the sale. The lender should not rely on a financial guarantee, as it can take a significant amount of time and extensive litigation to enforce.

Determining the true value of a work of art is difficult for a number of reasons. Assuming the work of art is authentic, value is dependent on subjective factors such as tastes, cultural trends

[7] Artemundi Global Fund. "Liquidity in the Art Market."

and speculation. There is no true mark-to-market valuation method for art, as each piece is unique. Looking at recent sales of similar works is the only way to estimate market value if the piece in question has not been sold recently. Often there are no recent sales of similar works by the same artist, making it more difficult to determine an accurate value. Due to the lack of transparency in the art market, details about private sales are challenging to ascertain. Appraisers have sales information from public sales at auction houses and limited price discovery from private sales available for their evaluation. Without a full view of the entire market, an appraisal might not capture what the work of art could be sold for privately.

The fine art market is difficult to analyze due to the low volume of transactions, the uniqueness of each individual work of art sold, and the lack of private sales data available.[8] Jianping Mei and Michael Moses, professors at NYU's Stern School of Business, constructed and analyzed a data set of repeated sales information to create an annual index of art prices.[8] Purchased by Sotheby's in 2016, the Mei Moses Art Indices (now Sotheby's Mei Moses) is based on an expanding database which contains sales information on 45,000 different artworks that have been sold at auction more than once.[9] Of the 45,000 artworks, approximately 4,000 change hands each year, providing recent sales information to the database.[9] The Mei Moses World All Art Index compound annual return was 5.26% from 1995-2015 and 7.89% from 1965-2015.[4] As a lender, it is comforting to know that the collateral has historically appreciated over time. Due to the characteristics of the art market, however, there are several flaws associated with the repeated sales method. According to the TEFAF 2017 Art Market Report, only 37.5% of artworks sold in 2016 were sold through auction houses.[10] Additionally, the 4,000 transactions captured by the database represents a small fraction of the total auction transactions in a given year and does not include bought-in works of art. As a result, this index should not be treated as the gold standard but should instead be used as one of many tools available for the valuation process.

The key variables affecting the value and price volatility for a specific work of art are its artist, genre, and condition. Price levels across different genres or movements do not move together. The total sales value for Post War/Contemporary art peaked in 2014 at $8 billion. The total sales value in 2016 was $5.6 billion, down 18% from 2015 and accompanied by a 12% drop in transaction volume. Sales of Modern Art dropped by 43% to $2.6 billion in 2016, with a 6% decrease in transaction volume. During the same timeframe, Impressionism/Post Impressionism saw a 31% decline in sales by value to $1.3 billion, but a 13% increase in transaction volume. Old Masters experienced a 5% increase in sales to $1.4 billion and a 12% increase in volume.[11] All of these differences illustrate that sales trends are not constant among different genres or movements. Similarly, values of works by certain artists are more volatile than others. Lending

[8] Mei, Jianping, and Michael Moses. "Art as an Investment and the Underperformance of Masterpieces."
[9] Sotheby's. "Sotheby's Acquires the Mei Moses Art Indices."
[10] Pownall, Prof. Dr. Rachel A. J. "TEFAF Art Market Report 2017."
[11] McAndrew, Dr. Clare, and Art Basel. "The Art Market | 2017."

against works that exhibit lower price volatility gives the lender greater confidence that the buffer created by the loan-to-value ratio will provide adequate capital protection.

A low loan-to-value ratio is one method lenders can use to protect from significant price swings. For example, a $500,000 loan on an artwork appraised for $1 million would equate to a 50% loan to value ratio. The value of the art used as collateral could decrease by half without affecting the lender's ability to collect the outstanding capital in an event of default (before consideration of sales costs). A low loan-to-value ratio also allows the lender to sell the painting below market value to facilitate a quick sale without losing principal or interest. Additionally, a low advance rate (i.e., a low loan-to-value ratio) can compensate for any transaction costs associated with the sale of the artwork. Shorter-term deals are another risk-mitigation method; by minimizing the number of days since the most recent appraisal, the likelihood increases that the appraisal price will remain accurate throughout the duration of the loan.

VIII. Establishing Provenance

In order to accurately assess value, the first crucial step during a full appraisal is determining authenticity. Traditionally, provenance and analysis from art historians are used to determine authenticity for any given work of art.[12] Determining the provenance – the history of ownership of a work of art, however, serves another purpose. The lender must establish provenance in order to determine whether or not a piece of art can safely be accepted as collateral. In addition to the chain of ownership, provenance includes information about attribution and where the art has physically moved in its lifetime. Incomplete or inaccurate provenance could leave the art vulnerable to repossession by an outside party or to a sudden loss of value, leaving the loan essentially unsecured. For a work of art to have "good" provenance, there must be a record that supports authenticity and exhibits a clear chain of title.[13] Incomplete provenance generates suspicion related to origin and rightful ownership. Unexplained gaps in provenance could indicate that the piece of art has been stolen or illegally exported in the past. Gaps in provenance, however, do not necessarily mean that the art was forged or that another party has a claim to ownership. The opacity of many art transactions may make it difficult to find a written, detailed record of past sales. Buyers and sellers often want to remain anonymous, and the sale price via private exchanges frequently remains hidden as well. Additionally, in the case of older works of art, it is improbable that a complete record of every sale has survived and accompanied the art throughout its lifetime. Because it is difficult to have a truly complete provenance, what is considered to be "good" provenance varies. For example, an American Hudson River School painting could be sold or accepted as collateral with some gaps in provenance without raising too many questions. On the other hand, an investor would be rightfully wary of a Gustav Klimt that vanished from records in Austria in 1940 and appeared again a few years later.[13]

Attribution of a work of art is a key element of establishing provenance. Change in scholarly opinion as to the source of a work can wipe out the value. It is wise to avoid pieces for which

[12] Morden, Apryl. "Interdisciplinary Practice and Attribution: Challenges Facing the Catalogue Raisonné in an Authentication Framework."
[13] Braun, Steven J. "Art as Objects of Desire and Collateral, Issues of Title and Provenance."

there might be a question as to who created the work. In addition to ensuring that the art is not at risk of cultural repossession, authentication experts must be wary of fakes and forgeries. Forged works of art are often accompanied by falsified records in order to create the illusion that the work has good provenance. One such scheme, engineered by John Drewe with the assistance of painter John Myatt, was carried out from 1986 to1995. Myatt, who could imitate the likes of Braque, Matisse, Giacometti and Le Corbusier, produced forgeries for Drewe to sell. Using his in-depth knowledge of the appraisal process, Drewe ingeniously concocted fake provenances for Myatt's works by gaining access to supposedly secure art archives to change the provenance of authentic paintings and insert fake records for Myatt's forgeries. Using this method, Drewe was able to create gaps in the succession of works by an artist in order to create space for Myatt's creations. Together, the pair were able to produce and sell over 200 forged works.[14]

Authentication experts look at the following to establish provenance:

- Certificate of authenticity
    - Art can be examined by an authentication board or artist-endowed foundation formed to validate works with unclear claims of artist attribution. These foundations and boards, often established by the heirs of an artist, may issue a type of certificate of authenticity if they determine the attribution claim to be true.[13]
- Catalogue raisonné
    - Fine art is often evaluated alongside a catalogue raisonné. A catalogue raisonné is a set of documents detailing all known works produced by an individual artist, including the date, medium, provenance, dimensions and illustration of each work if available.[15]
- Invoices, appraisals, auction records, purchase agreements, correspondence and other sales documents
    - These documents are useful for determining the purchase price, condition, and location of a work as of a certain date. Records of attempted sales can be useful as well, and can include all of the information listed above except for an actual purchase price.[13]

[14] Landesman, Peter. "A 20th-Century Master Scam."
[15] International Foundation for Art Research. "Catalogues Raisonnés Users' Guide."

- Insurance certificates, exhibition records, appraisals, and photographs
  - These records – typically held by current or past owners –can provide a glimpse into the art's value, condition and location while in the possession of a particular owner.[13]
- Export permits, lawsuit records, scholarly articles, museum catalogues
  - Generally available to the public, these documents are also used to establish provenance as they may contain information about value, ownership and location.[13] Export permits are only given in Europe.
- Stolen art databases
  - Databases for stolen art can be accessed by the public with varying degrees of difficulty. The FBI's National Stolen Art File is only available through a law enforcement agency. But access to Interpol's database of approximately 28,000 pieces of stolen art is available to the general public. Additionally, private research databases such as the International Foundation for Art Research (IFAR) contain information and registries for stolen works of art.[13] The National Archives maintains the International Research Portal for Records Related to Nazi-Era Cultural Property, specifically related to art and other property stolen during the Nazi era.[16] This concentrated database allows authentication experts researching provenance to access a large collection of records on art that could be subject to cultural repossession.[13]

Some documents mentioned in the list above may be lost or nonexistent, but each is useful in establishing provenance for a piece of art.

Title insurance for art is a relatively new product that has not become popular in the art-secured lending market. In 2006, ARIS first launched its title insurance offerings in the state of New York.[13] Most lenders would rather rely on appraisers for valuation and authentication experts for attribution and authenticity than incur the cost of title insurance.[4] With premiums in the range of 1% - 4% of the sale price, neither lenders nor borrowers are willing to cover the cost of the policy.[13]

IX. Security of the Collateral

It is critical that the lender obtain a perfected security interest in the collateral of an asset-backed loan in order for its rights in the collateral to be superior to the rights of the borrower's other creditors as will as a bankruptcy trustee of the borrower. In the U.S., lenders file a UCC

[16] National Archives and Records Administration. "International Resources for Holocaust-Era Assets Research."

financing statement in order to perfect a security interest in the collateral.[17] While the filing of the UCC financing statement perfects the security interest possession of the collateral provides the lender with physical control of the collateral. With a UCC statement as perfection, what happens if the borrower decides to take off with the piece of art? Art is relatively lightweight and portable when compared to other real assets such as real estate and equipment. As a result, there is always the risk that the borrower will steal or hide the art if he or she defaults on the loan and is required to turn over the art to the lender. Any litigation needed to recover the collateral from the borrower in an event of default wastes valuable time and resources. Taking possession of the art eliminates these risks and enables the lender to begin the process of selling the collateral as soon as the borrower defaults on the loan.

Taking possession of the art also gives the lender control over the storage conditions. Changes in temperature can cause wood and fabrics to split, tear, or become brittle. Excess humidity can allow mold and mildew to grow on the art, depending on the material. Because 50% - 55% humidity is optimum for preservation, the storage facility used to store the art should have an accurate and precise HVAC system.[18] A bonded warehouse with experience storing fine art is able to safely store fragile or sensitive items in a climate-controlled environment with a management team dedicated to security.

It is of course impossible to guarantee that the collateral will not be damaged, lost, or stolen during the loan, even with the aforementioned security measures in place. The art used as collateral should be insured for the full appraised amount and for the entire duration of the loan. The lender should understand all events covered by the insurance along with all exclusions or gaps in the coverage. While ideally the art is covered in any adverse scenario, the bond on the warehouse might only cover certain gaps in the insurance policy. The policy should not be at risk of cancellation due to any action by or negligence on the part of the borrower throughout the duration of the loan. Insurance providers charge premiums of 0.2% to 0.3% of the art's value to insure for elementary damage and theft. To reduce counterparty risk, coverage should be provided by an established and reputable insurance provider with experience in the fine art space. With these safeguards in place, the lender can be confident that the collateral is secure throughout the duration of the loan.

If the borrower is in default and a sale of the art does not fully cover the amount owed to the lender, a financial guarantee gives the lender the legal right to pursue all other assets owned by the borrower to collect the remaining amount owed. The guarantee provides the lender with a signed legal promise from the borrower stating that he is responsible for repaying the full amount owed. This guarantee, if implemented, provides the lender with a final layer of security in an event of default.

X. Suggested Process

One approach to lending against fine art is to source loans through a loan originator, ideally someone with experience working in fine art finance, and/or at major auction houses. A loan originator who can generate significant deal flow will give you a wide variety of loans – and art – from which to choose. Preferably, the loan originator will create an alignment of interests by

[17] California Secretary of State. "UCC Financing Statement."
[18] Fortress. "FAQs."

participating alongside the lender. Thus, the originator is directly invested in the success of the loans and is not simply collecting origination fees. It is important to define the terms of the relationship with the loan originator in the Participation Agreement so that in the event of a default, each party's responsibilities and rights are established beforehand.

In order to properly compare different loans, it is important to identify the essential terms and characteristics of each deal to develop a static "buy box" defined by these crucial factors. Ideally, the focus should be on loans with a short duration and an attractive rate that compensates the lender for the risks associated with this asset class. Furthermore, it is wise to loan against museum-worthy art. Art that is desirable enough to be accepted at the major auction houses (i.e. Sotheby's, Christie's, Bonhams, etc.) will be easier to sell quickly in an event of default.

To further minimize risk, it is important to lend against multiple different works of art. Ideally, the portfolio of collateral will include works of art produced by different artists across different genres and movements. With a well-diversified portfolio, a drop in value of works by one artist or downside volatility affecting a certain genre will not sink the value of all of the art accepted as collateral. Additionally, it is clearly important to lend to multiple borrowers in order to reduce counterparty risk.

The loan process entails a number of agreements and documents that secure the collateral, define the loan terms, and set out the legal responsibilities of the borrower, loan originator and lender.

- Appraisal documents
    - Keep an eye out for well-verified and "good" provenance. Avoid art from certain geographic regions and time periods, such as antiquities from the Middle East, North Africa, and other conflict areas. These works are at risk of being seized by their countries of origin under cultural repossession laws if they were stolen or illegally exported in the past, which would result in the loan being unsecured. The appraisal includes the current value estimated by the appraiser, past sale prices, and recent sales prices of comparable artworks.
- Insurance certificate
    - Verify that the art is insured for the full appraised amount, and obtain the insurance certificate. When lending against multiple works of art, make sure each individual artwork is covered and that the coverage continues for the full term of the loan. Check for any exclusions or gaps in coverage. Some scenarios may not be covered by insurance and instead are covered under the warehouse bond. Ensure that the borrower cannot cancel the insurance during the term of the loan.
- Promissory grid note
    - The promissory grid note lays out the terms of the loan, including the amount, interest rate, amounts owed in an event of default, default scenarios, and the

maturity date. In addition, it establishes that the borrower is liable for expenses relating to collections and enforcement of the note's provisions.

- Loan and security agreement (LSA)

    - The LSA goes into further detail on the terms of the deal and the required security of the collateral. It explains the calculation method used to determine the interest amount owed. The LSA establishes that the borrower owns the collateral free and clear of any other liens, and that the borrower is in good financial condition. It states that the lender's name is added to the insurance as a lender loss payable endorsee, and that the insurance cannot be cancelled as a result of any actions by the borrower. The LSA gives the lender important rights such as the right inspect the art at any time. Along with the UCC statement, the LSA affirms the agreement of all parties that the lender has a first priority lien on the collateral. Often there are prepayment penalties defined in the LSA that discourage prepayment or give the lender a boost in return if the borrower repays the loan early. Calculating the interest in advance for the full term of the loan gives the ultimate protection against prepayment. Additionally, the LSA provides that the lender has received a signed financial guarantee as a final layer of security.

- Origination agreement

    - The origination agreement establishes the origination fee and any fees owed to the loan originator if the loan is extended beyond its initial maturity date. It identifies the originator's responsibilities during the loan and in an event of default. In addition, it includes the sales commission and fees owed to the originator if the art is sold at the borrower's request during the loan, or in an event of default. The origination agreement also gives the borrower the right to redeem the loan and recover the collateral before a sale, provided that the borrower pays all principal, interest, and other fees and expenses owed to the lender, originator, and other parties involved in the sale.

- Other documents establishing the relationship between the loan originator and the lender

    - These documents list fees that are shared by both the loan originator and the lender, as well as the exact percentages owed to each party to avoid ambiguity. They also lay out the payment priorities, and may give the lender the ability to purchase the entire outstanding equity in the loan from the loan originator

It is important that the lender be legally insulated as much as possible in case the loan originator goes bankrupt. One method is to establish a Special Purpose Vehicle (SPV) to house specific loans. With careful drafting, the SPV may be made "bankruptcy remote," with ownership transferred to the lender if the loan originator becomes insolvent.

After the structure of the loan is established, multiple steps must be taken in order to ensure the collateral will be physically secure throughout the duration of the loan. The art used as collateral should be stored in a bonded warehouse of the lender's choosing. While the UCC secures legal ownership of the art in an event of default, being in possession of the collateral eliminates the challenge of recovering the art. The lender should obtain pictures of the art in the storage crate or packaging, and save the warehouse receipt to guarantee that only he can remove the art from the warehouse during the loan.

Even with the security measures and above documentation in place, it is wise to monitor the collateral as well as the status of the loan during the term of the loan. As Ronald Reagan often said, "Trust, but verify"; although due diligence has been performed on the loan originator and the loan is structured to ensure an alignment of interests, one can never be too careful. A third party auditor should be retained to monitor the status of each loan and check that the collateral remains safely stored in the warehouse. The auditor will review the accounting records of the loan originator to verify that the loans were made, which requires confirmation from the borrower. The auditing group will also visit the warehouses and verify that the art is stored properly and that its condition has not deteriorated. In addition, they will take photographs to compare with the original images taken at the start of the loan.

XI. Conclusion

Armed with a deep understanding of the risks associated with art as an underlying asset, an investor is able to prepare for potential challenges that may arise. The structure outlined above provides both security and control over the investment, allowing the lender to access the attractive returns provided by art-secured loans without exposure to the unforeseen risks unique to art-secured loans.

Our goal is to empower investors with this roadmap. For the self-directed, doing it on their own will suffice. However and at a minimum, we strongly suggest engaging a loan originator. Most want the watch only to tell the time versus learning how it was built, and for them this research paper may kindle interest and conviction for participation but they may seek an advisor for implementation. For this group, Shinnecock stands ready to help.

Appendix A: Critical Variables

Provenance/Ownership of the Property

- Well-documented and complete provenance
  - Methods/Sources[12,14]
    - Independent authentication documents
    - Catalogue raisonné
    - Sales documents, including records of attempted sales
    - Owner's documents
    - Public documents
    - Registries and research services
- No liens on the property
- No litigation against the property
- No Cultural Protection laws

Value

- Enduring value
  - Quality of art
  - Quality of artist
- Price volatility
- Type of art
- Appraisal by third party

Ability to Recover Property

- Stored in a bonded warehouse of the lender's choosing
- UCC Financing Statement

Condition

- No damage or alterations since appraisal
- Storage facility with controlled temperature, humidity, lighting, and pest control

Borrower's Financial Situation

- Financial guarantee (corporate and/or personal)
- Complete and accurate financial information from the borrower
- No litigation against the borrower

Insurance

- Insurance for the duration of the loan
- Amount of insurance

Appendix A: Critical Variables (continued)

Deal

- Interest rate
- Loan to Value (LTV)
- Term
- Fees
- Costs to borrower

Appendix B: Bibliography

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