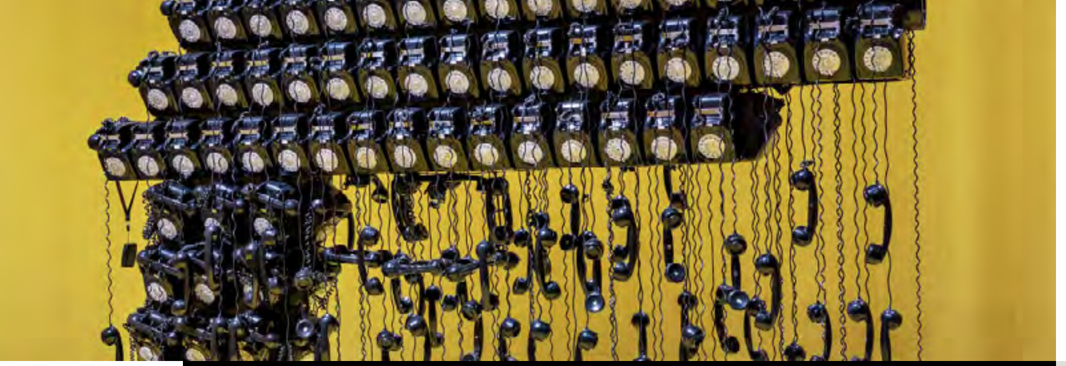

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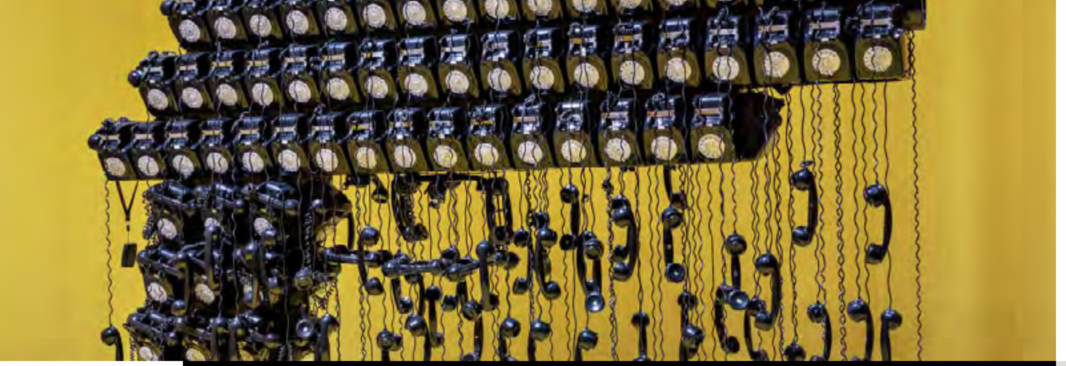
Case Study

Post-pandemic art financing in the non-banking market

How responses to COVID-19 altered the art market, the impact on specialty lenders, and the ongoing effects on specialty lending practices going forward

While 2020 saw the largest global art market contraction since 2016, the decline did not lead to fewer art-backed loans. Instead, the COVID-19 pandemic led to increased interest in art-secured lending. Some specialty lenders saw more than a 75% increase in requests from 2019, as private collectors looked to unlock equity from assets that were not impacted by the initial shock of the pandemic. This was particularly true among collectors who operate in the middle of the market, where activity began to surge once galleries and auction houses pivoted due to the challenges posed by COVID-19 and expanded their virtual presence.

Interest rates and the middle market
Lower interest rates have helped to spread awareness of art-secured lending and have created more demand. Rate changes can affect the lending practices of bigger banks, but they tend to offer art financing as an accommodation to a subset of their client base who seek loans beginning at US$10 million and have significant assets under management (AuM). TPC Art Finance, which caters to the upper middle of the market, remains largely unaffected by changes in rates and offers loans solely against collections of artworks starting at $500,000 with an ability to offer financing equal to other institutions. Similarly, inflation or any other market inflection does not seem to immediately impact the art lending space. Overall, the art market tends to lag behind such macroeconomic shifts, if it is affected at all. Instead, education about the economic benefits of borrowing against a work of art, in lieu of selling, has a greater influence. Through borrowing, collectors can avoid capital gains and other tax implications, and redeploy funds as they see fit. As firms like TPC Art Finance continue to be accessible and further streamline the process, we hope to see an increase in activity. With this broader lending base, collections and collectors that may have been overlooked by banks can benefit from the same opportunities and leverage more recent entrants to the secondary marketplace.



The pandemic also leveled the playing field, breaking down barriers of communication.

This is where the market is at its most dynamic and where art-secured lending will likely see the most significant growth in coming years. The ultra-contemporary (artists born in the mid 1970s or later) segment of this market is particularly strong—the total generated by global sales increasing by 142% from March 2019 ($35.7 million) to March 2021 ($86.7 million) at auction alone, with the majority of sales in this category happening privately or through galleries[1]. Collectors in this sector are often newer to the market and more inclined to recognize that works of art can serve as a smart financial solution for their short-long term investment strategies. Regardless of differing rates, many collectors at this level, and even above, may not have ample capital, other AuM, or a large enough collection for their banking institutions to support a loan against said collection. Rather than wait to benefit from significant value appreciation, a collector can immediately seek liquidity through art-backed specialty lenders to continue to add to their art collection or diversify their portfolio with other investments.

There has been a heightened use of new technologies, including digital sales platforms, data aggregation tools, and advances that allow for higher quality and dimensionality of imaging and display, which has generated increased participation in online sales and brought in new collectors. This has fostered a greater amount of comfort in the idea of using art as leverage.

Breaking down barriers

The pandemic forced galleries and auctions to move to online platforms, which helped to further democratize the market, while the adoption of virtual platforms meant that more collectors could be exposed to new pieces and artists. The comprehensive set of digital tools are now actively being used to view art in the non-physical world allowing the average number of times a work is viewed to multiply exponentially.

The pandemic also leveled the playing field, breaking down barriers of communication. Anyone could plug into numerous panels through various online portals and listen, learn, and educate themselves about collecting. Dealers, gallerists, and even artists also became more accessible since everyone was suddenly a direct message or an email away.

Third, by moving online, auctions could take place with greater frequency. Surprisingly, participation did not ebb. Rather, there was increased activity in bidding globally, which ultimately led to higher hammer prices. Christie's reported in May 2021 that the auction house has seen online registrants surge 26% from May 2020, that a total of 5.5 million global viewers from around the world tuned into their livestream auctions, and that bidders across 15 sales hailed from 58 different countries.[2]

These factors converged to make the middle market more dynamic. Increased participation then led to an increase in the need for financial services—and industry leaders see no reason why these trends will not continue.

Art-lending and the auction market

The auction market is an important aspect of the loan underwriting process because it offers transparency into an artist's depth of market. Increased frequency of auctions and increased sales means more data, which allows lenders to better assess potential risks associated with lending against specific artists and works of art produced during specific time periods.

An examination of Shara Hughes' performance is illustrative of this point. Following her inclusion in the 2017 Whitney Biennial, her work has experienced a sharp and sustained increase in hammer prices that have far exceeded estimates. The hammer price of I don't Deserve These Flowers, for example, increased by more than 1600% between 2017 and 2021, and outperformed mean estimates in the two sales by a factor of 3.75 and 5.94, respectively. The performance of Water Tower, which saw sales in 2018 and 2020, reveals a similar trajectory, both in terms of the increase in hammer price (260%) and factors by which the two sales outperformed mean estimates (2.5 and 3.5, respectively).[3]

1 Julia Halperin, Which Segment of the Art Market Grew the Most in Last Month's Mega-Sales? We Crunched the Numbers, June 24, 2021, available at https://news.artnet.com/news-pro/may-2020-art-auction-1982975
2 Christie's, Hong Kong Auctions May 2021, available at https://www.christies.com/auctions/hong-kong#overview_Nav
3 TPC Art Finance (2021) sourced from Artnet

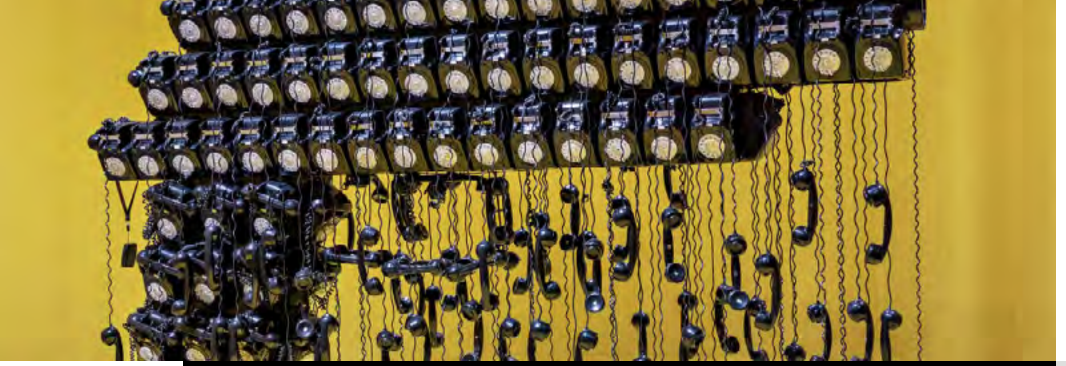
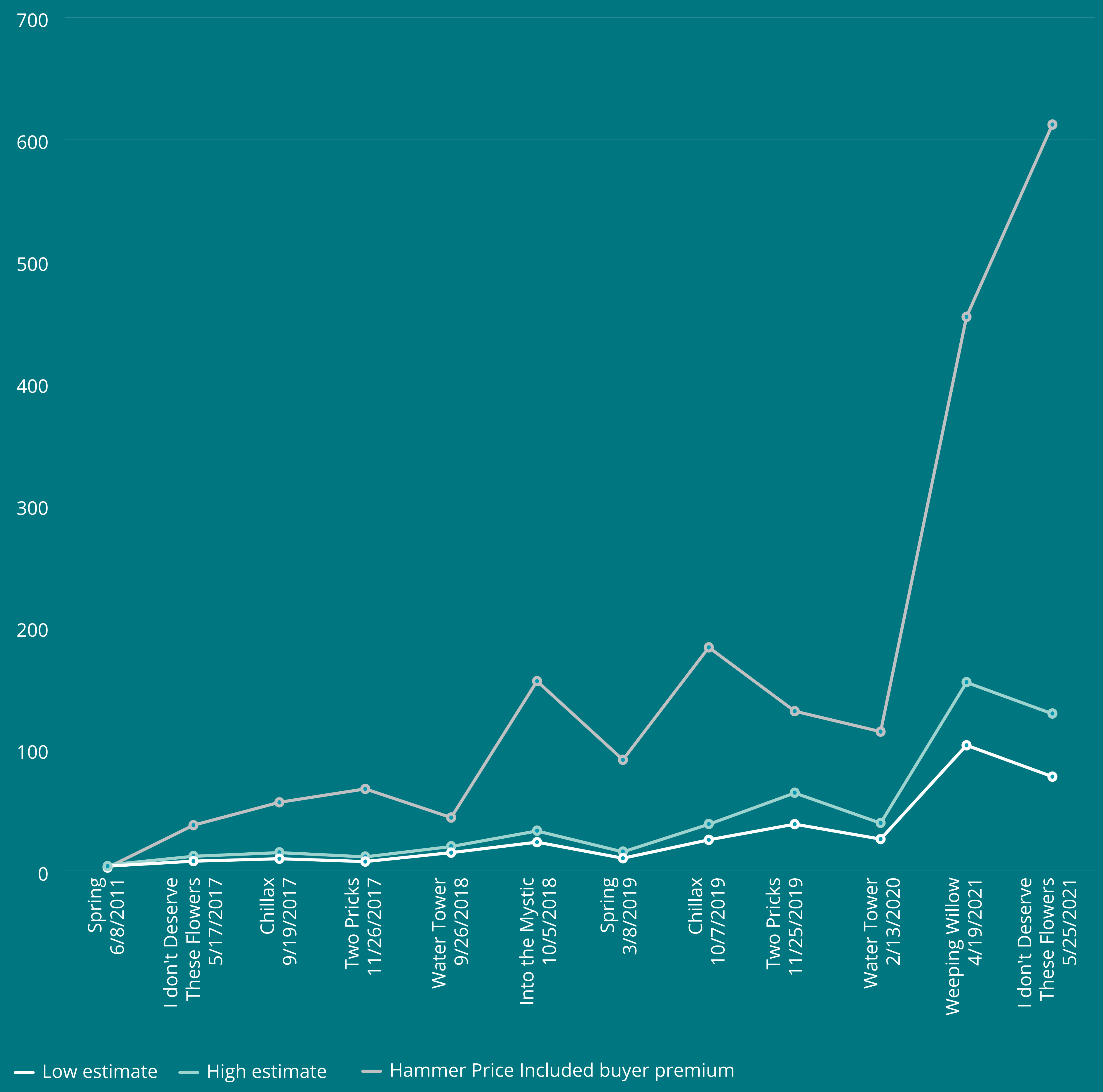


Figure 79. Shara Hughes estimates & sales ($1000s)



Given these trends, collectors who are seeking capital may prefer to retain works by artists like Hughes. Taking out a loan affords them the opportunity to not only borrow against these works now, but to upsize the value of their loan should the works continue to increase in value. Specialty lenders offer them the opportunity to do so, thereby catering to a part of the market's ecosystem that is younger and more active. Furthermore, as these individuals' collections grow and their interest in more valuable works of art increases, their reliance on art-secured lending will likely continue, both growing the industry and popularizing the practice.

Trends in Asia

In 2020, China maintained an 18% share of the market, placing the country behind only the US (44%) and the UK (20%), but maintained the largest market share for works below $50,000 and works between $50,000[4] and $1 million. The latter price segment includes works of art that could be used to secure a loan through a specialty lender, which presents a clear market opportunity for specialty lending in Asia. There is a growing belief that Asia will soon emerge as a major hub to source loan activity to be rivaled only by the US.

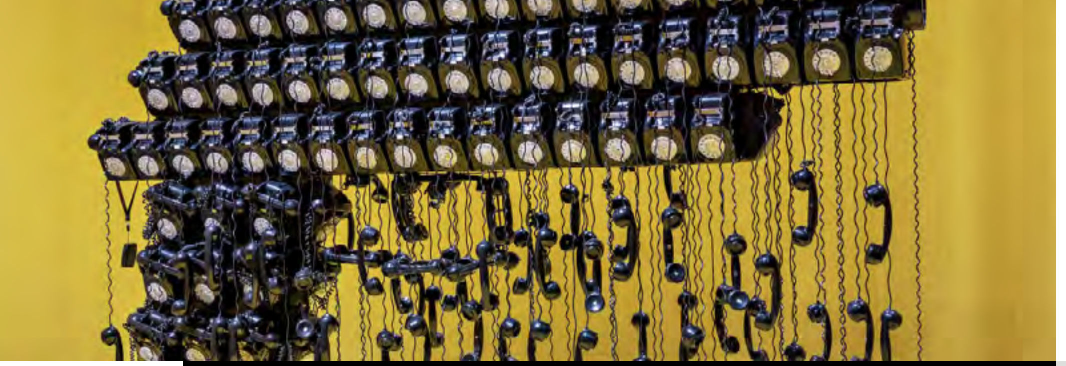
Asian collectors tend to be younger, more comfortable buying art for the first time, and more capable of adapting to market dynamics, which suggests that they may follow in the footsteps of American collectors. They will likely recognize the use of art financing tools in a manner akin to American collectors, even if homegrown infrastructure to facilitate these deals has not emerged at this time. Given that there are relatively few ways to obtain a loan within some parts of Asia, most notably China, specialty art lenders from the US could become a source of capital for these collectors. They may recognize that specialty art lenders offer them the opportunity to leverage their existing holdings, further fueling growth in the space.

Final thoughts

We are now in a new generation of the art market and one in which we hope transparency and technology will continue their presence and growth as it has proven to encourage new peer participation. It is anticipated that this will increase the utility of specialty art lending and help fuel growth and activity.

Bespoke art financing provides resources and opportunities designed to support individual liquidity needs. As the lending market evolves over the next five years, we expect to see a shift in how loans are structured in line with more traditional financing products, including insurance policies that remove the default and valuation risk, in turn enabling lenders to increase loan-to-values and offer borrowers more competitive rates. These new methods of reducing risk and larger loan pools will also mean that securitization becomes a bigger possibility. The industry has grown and will continue to do so as collectors get more savvy, educated, and truly look at borrowing against works of art as an opportunity, not a necessity.

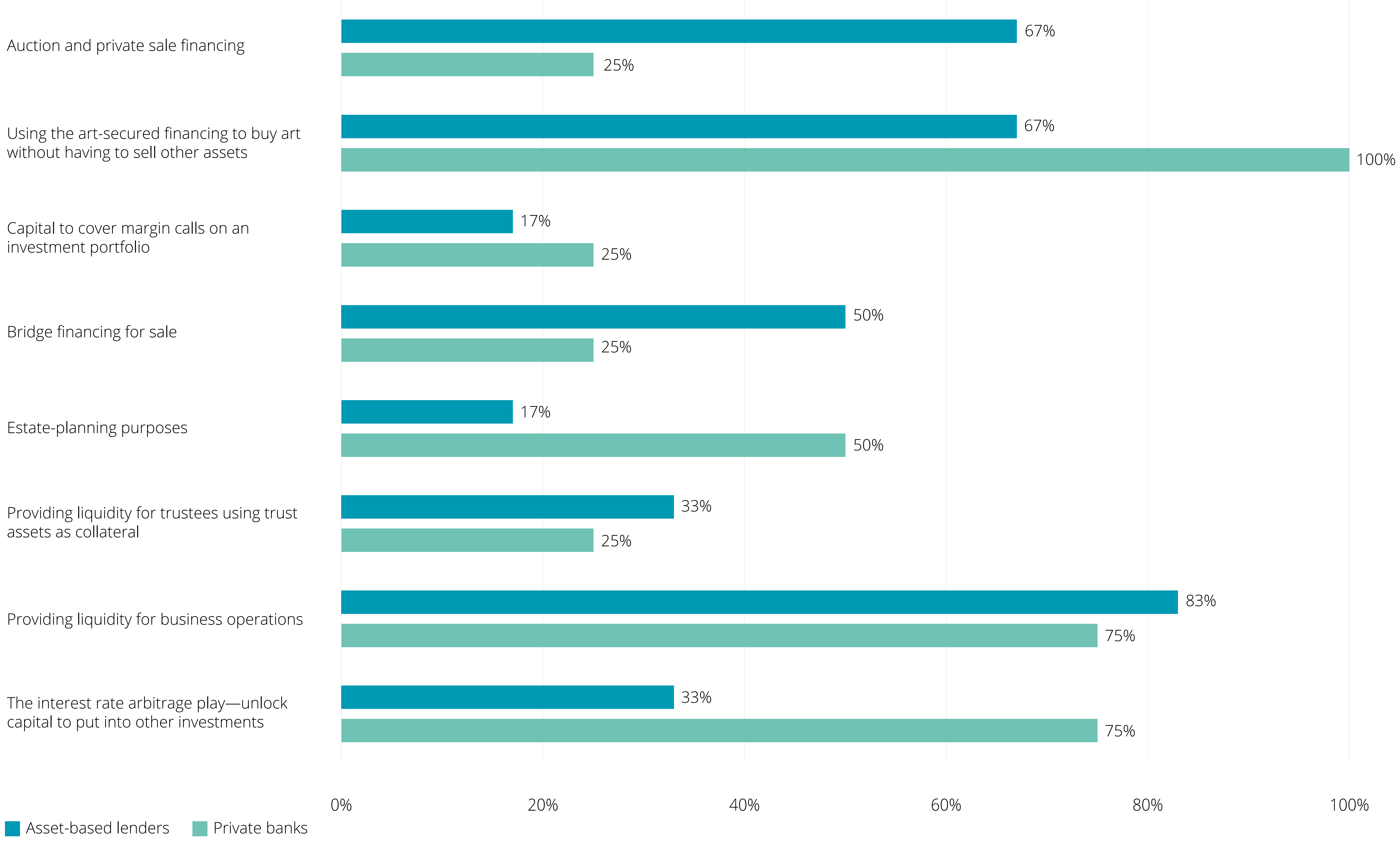
4 Claire McAndrew, The Art Market 2020, available at https://d2u3kfwd92fzu7.cloudfront.net/The_Art_Market_2020-1.pdf



Art secured lenders—survey findings 2021

Demand drivers for art-secured lending

Figure 80. What are the most important "demand drivers" for art-secured lending services over the last 2 years?
Source: Deloitte Luxembourg and ArtTactic Art & Finance Report 2021



Transaction financing is a key demand driver
All the private banks surveyed said using art-secured financing to buy art without having to sell other assets was a key driver for their art-lending business, and 67% of asset-based lenders said the same. A further 67% of asset-based lenders said auction and private sale financing was a key driver for the demand in art-secured lending, compared with 25% of private banks. Half the asset-based lenders said bridge financing for a sale was a key growth driver in the market, compared with 25% of private banks.

Providing liquidity for business operations:
75% of private banks indicated that the need for liquidity for business operations was a key driver for art-secured loans, and 83% of asset-based lenders said the same.