PRESERVER PARTNERS

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Alternative Income Through Secured Art Lending

Secured art lending is a form of asset-backed lending, secured by one or more artworks. The opportunity for secured art lending is driven by the demand from collectors, gallery owners and dealers looking to access the value of their art collections without selling the artworks. Selling artworks is a less attractive option for multiple reasons: (i) there are often multiple steps in the sale process including obtaining independent appraisals, documenting provenance and shipping, (ii) auctions can be expensive as auction houses, art dealers and galleries charge sales fees, (iii) a capital gains tax would apply to the sale, plus potential state and local taxes, and (iv) because collecting art is often both a passion and an investment, owners can be reluctant to sell cherished artworks. Borrowing against their artworks allows the owner to avoid the pain points of selling, while maintaining ownership of the artworks and benefiting from future price appreciation. Art dealers, gallery owners or individual collectors often use loan proceeds to make further art acquisitions, refinance their current inventory, or to pursue other business opportunities.

There are different types of fine art lenders. Private Banks have most of the market share as they provide services to ultra-high net worth individuals, who also have substantial managed portfolios with the Private Bank. Auction Houses have the smallest amount of market share. Auction Houses focus on the quality of art when providing financing, unlike Private Banks, and often require the borrower to purchase other services from the Auction House before providing financing. In addition to Private Banks and Auction Houses, there are also Boutique Lenders that have some competitive advantages over Private Banks and Auction Houses.

Mick Clowers joined Preserver in 2018 as Senior Investment Associate. He works with the Chief Investment Officer and Operational Due Diligence team to conduct investment research on new and existing investments. Prior to joining Preserver, Mick served as a Portfolio Manager (2011-2017) and the Director of Portfolio Management (2017-2018) at Legacy Wealth Management. He graduated from the University of Memphis with a B.B.A. in Finance. He obtained his Certified Financial Planner certification in 2014. He is also a CFA charterholder.

Boutique Lenders can complete loan processes and provide funds in a shorter time frame, they are often willing to tailor each loan to the borrower's specific needs, and they can often leverage their experience and industry relationships to obtain market insights and valuation expertise.

Preserver has partnered with an experienced Boutique Lender to provide capital to finance short-term loans, secured by museum-quality fine art. Given that the lender has the ability to tailor loans for each borrower and provide funding in a short time frame, the loans are structured with attractive yields, short durations and favorable loan structures. Borrowers historically have been willing to accept 9-10% interest rates and 1-3% origination fees. Loans are short-duration, often structured with an initial 12-month term that can be extended at the borrower's request and at the lender's discretion.

Given that fine art is unique collateral, diligent loan structuring and credit underwriting are paramount. Some of the key favorable loan structures include:

- Lender possession of the art collateral during the loan term;
- Low average loan-to-value ratio;
- Independent appraisals to establish a current fair market value for the collateral;
- Corporate and personal guarantees from the borrower;
- Requirement that the borrower prepay all interest before loan proceeds are disbursed to the borrower; and
- Requirement that the borrower either obtain insurance for the collateral or work with the lender to obtain insurance paid by the borrower.

In addition to favorable loan structuring, the lender also underwrites the borrower's credit quality, runs background checks on key principals, analyzes ownership provenance of the collateral, and analyzes the liquidity of the collateral based on the artist and art genre.

When compared to public fixed income markets with historically low yields and meaningful credit and duration risks, Preserver believes art secured lending provides investors with attractive interest income while limiting duration and credit risks.