Unlocking the Value of Your Art

By ANDY AUGENBLICK

Most collectors have tremendous value locked up in their art and antiques. When it comes time to unlock that value, they don't necessarily have to sell their art to create liquidity.

BORROWING VERSUS SELLING

Collectors should consider borrowing against their collection: They can borrow funds for up to 20 years — and retain possession of their art.

There are significant advantages to borrowing. Most compelling is the avoidance of selling costs (e.g., an auctioneer's or dealer's commission) and capital gains taxes. Many people don't realize that the long-term federal capital gains tax on art and antiques is 28 percent (versus 15 percent for stocks, bonds, and real estate). Adding state and local taxes, a sale can actually trigger a total tax bill of 40 percent or more on the gain. That's *before* selling costs, which can be as high as 30 percent of the value of the assets sold.

This combination can make it very expensive to sell. Let's look at an example. A collector sells his art for $5 million. Assuming selling costs of 20 percent (20 percent of $5 million = $1 million) and an original cost of $500,000 for the art, he realizes a before-tax profit of $3.5 million. This profit is subject to capital gains tax. Assuming a rate of 40 percent (28 percent federal plus 12 percent state), the collector pays $1.4 million in capital gains tax, and nets $2.1 million.

These net proceeds are subject to estate taxes at the collector's death. Assuming a 50 percent rate, the heirs receive only $1.05 million — on art sold for $5 million! This represents a loss of 79 percent across a single generation, and underscores the cost of selling art. By selling during his lifetime, the collector pays two levels of tax: capital gains and estate.

By borrowing to create liquidity, the collector can keep the art during his lifetime and have his estate benefit from a step-up in tax basis. This enables collectors to pay just one level (estate tax) rather than two. In this example, the collector could borrow as much as $2.5 million (up to half the art's value) and keep his art. He would be responsible for debt service on the loan, but would also benefit from any appreciation on his art.

COLLECTORS BORROW FOR AN ARRAY OF REASONS

- Many arrange lines of credit and term loans to buy more art.
- Some whose wealth is concentrated in art borrow funds to invest in other asset classes, such as stocks, bonds, real estate, oil, gas, private equity, and hedge funds, thereby diversifying their holdings.
- Entrepreneurs frequently borrow against their art to invest in their existing businesses or new ventures.
- People also borrow against their art to make charitable contributions, pay medical expenses, and fund divorce settlements.
- An art-based loan is a low-cost option for people in need of cash flow who can enjoy their art while making scheduled payments.
- Faced with estate taxes that must be paid within a short time frame, executors frequently liquidate art collections quickly. But borrowing funds to pay estate taxes and administration costs makes it possible for executors to maximize the value of the estate's assets by selling the art over time, thus avoiding a "fire sale."
- In these uncertain economic times, collectors also borrow to avoid the risk of having their art "bought in" (or "burned") at auction, which makes it difficult to sell for years to come.

FINDING A LENDER

Collectors interested in arranging financing should identify their borrowing need, determine what type of financing makes the most sense, and contact the appropriate lender. Consult a financial advisor, accountant, attorney, or estate planner while making these decisions.

Does the collector want a six-month loan to fund short-term liquidity needs? Or an advance against art that he plans to sell later this year? Does he want the flexibility of a line of credit or a term loan of 5-10 years? These needs often determine which type of lender the collector should contact.

Today, art financing is available from banks, auction houses, and special purpose lenders. Banks, including Emigrant Bank Fine Art Finance, Citigroup, and Bank of America, offer loans to high net worth individuals, galleries, trusts, and museums. These financial institutions assess both the borrower's art and financial creditworthiness. Loans are typically priced at traditional bank rates, ranging from Libor plus 2 percent to Prime plus 2 percent. Clients can arrange lines of credit or term loans of 1-5 years though Citibank and Bank of America, or of 1-20 years from Emigrant. These banks lend up to 50 percent of the art's value and typically allow clients to retain possession of the collateral.

Christie's and Sotheby's offer short-term loans, generally for up to one year. In many cases, they are structured as advances of 40-50 percent of the low-end auction estimate of the artworks consigned for upcoming sales. These loans, typically priced at Prime plus 2 percent or Prime plus 3 percent, are asset-based transactions, meaning the amount of the loan is determined by the value of the art and not by the borrower's creditworthiness.

Finally, a small group of specialty lenders offer loans of up to three years at higher interest rates. Clients can borrow 50 percent or more of the value of the collateral. These loans, typically priced at Prime plus 3 percent to Prime plus 10 percent, often require borrowers to surrender possession of their artworks. These loans are often underwritten based on the value of the collateral, as at the auction houses.

Selling art is often an attractive option, but in many other cases, people can unlock the value of their collections in a lower-cost, more tax-efficient way by arranging an art loan.

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