Citigroup Inc

Top-notch art oils the wheels of lending

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In a speech to Britain's Royal Academy in 1851, Prince Albert declared that "works of art, by being publicly exhibited and offered for sale, are becoming articles of trade, following as such the unreasoning laws of markets and fashion; and public and even private patronage is swayed by their tyrannical influence".

The democratisation of wealth has been the death knell of such aristocratic views of art. Collectors still buy fine art for its aesthetic qualities but have long acknowledged its role as a store of value or as a commodity to be sold for gain. Others, aided by their bankers, have gone a step further: they treat their collections as working assets.

Citigroup's Citi Global Wealth Management unit first offered art advisory services in 1979, assembling a team of professionals to counsel clients on buying and selling art. Since then, the art advisory unit has often served as the first point of contact with potential clients.

"Art is a passion; it's a way of engaging clients," says Suzanne Gyorgy, head of the division.

But it was an altogether different service, one offered concurrently with art advice, that lured many art-collecting clients to Citi.

"When the bank looked at clients' balance sheets, it realised that art made up a significant portion of their overall net worth. The thinking was that this was something that could be collateralised as a loan," says Ms Gyorgy.

Even in today's precarious financial environment, that decision looks prescient. Not only have sophisticated investors become increasingly strategic about debt, but also art market valuations soared in recent years – that is, until 2008.

Michael Moses, co-founder of the Mei Moses Art Index, says a compilation index of all leading art categories shows a 4.5 per cent tumble last year. But the fall follows what Moses calls “a great five-year run, with an annual compound return of 20 per cent”. Noteworthy, though, is that while categories such as old masters and impressionists continued to appreciate last year, pre-1950 American art saw a 26 per cent decline.

Ms Gyorgy says Citi clients who collateralise art fall into three broad categories. First are seasoned collectors who use loans in conjunction with their collecting activities. Second are private equity and hedge fund managers seeking a liquidity source to fund other investments. And third are clients who use collateral to fund projects such as new homes. What unites all these people are collections of museum-quality art.

“We want international and marketable art, so regional works with a small pool of collectors are not of interest,” says Ms Gyorgy. “And our minimum unit value per piece is $200,000. The majority of our loan portfolio is made up of traditional painting, sculpture, drawings and high-end photography. Post-war/contemporary and impressionist/modern constitute the largest portions of the portfolio.”

The task of valuing the works falls to Ms Gyorgy’s nine-person team, obviating the need to seek outside opinion. Given the gossipy nature of the art market, discretion is a significant selling point for clients. The art advisory unit’s expertise – every member has an academic, curatorial or auction house background – aims to ensure that valuations reflect market prices.

Once the art has been valued, clients are free to borrow against their holdings. The standard range is between $5m and $100m, although with higher-level approval clients can borrow more.

However, it is easy to imagine an unfortunate collector losing a prized Monet to a margin call, especially in today’s market. And the best works aren’t necessarily immune to wider market conditions. “Art, like any stock,” says Mr Moses, “has an enormous market component as well as an individual work component.”

But Ms Gyorgy says several factors prevent such a scenario, protecting both the client and the bank.

A significant mitigator is the bank's 50 per cent loan to value policy. Risk is also ameliorated by annual revaluations of loan portfolios, with "stress test" modelling to ensure that clients are not over-exposed to a particular artist or genre. The art advisory unit also takes account of results at the leading biannual London and New York auctions. And a final layer of oversight is provided by the private bank's credit and risk management team's close monitoring of the art market.

History suggests the bank's checks and balances should work. The period 1990-95 was one of the bleakest on record for the art market. Prices ended down 65 per cent according to the Mei Moses Art Index. The decline, however, took place over five years.

Still, the bank acts if it senses sentiment moving against a collection. "If we see things starting to soften, and if it looks like a certain artist is going to go out of favour, we will have a conversation with our client long before. You wouldn't fall into a traditional margin call situation," says Ms Gyorgy, adding that during her tenure the bank has never taken take possession of any client's art.

"Typically what happens is that one artist might drop and another one go up. We look for a diversified collateral pool and it usually ends up being a wash," she says.

Art, though, is usually just one part of a client's portfolio. If the bank's structured lending team notices that a client may face liquidity issues or that loan covenants are at risk of being broken, it may initiate a dialogue about a client's art holdings.

The most advantageous time to borrow against art is when equity valuations are low or stock markets jumpy. And while art-backed loans usually carry a higher interest rate than equity-backed ones – in current market conditions, Libor plus 2.5 per cent or more – their relative price stability has benefits.

"With equities, you get a better rate, but you have to live with the volatility, and you may get margin calls," says Ms Gyorgy. "With art lending, it's a really stable form of collateral."