S&I Review -Alternative investor: Art

In the third of our series of articles on alternative investments, we ask Marjorie Allthorpe-Guyton, Secretary-General of AICA International and President of AICAUK, to discuss how art has become so attractive to investors

Once the domain of sophisticated enthusiasts eager to add to their private collections, the art world has become an extremely lucrative market where investors can make huge profits in a relatively short space of time.

For example, explains Marjorie Allthorpe-Guyton, "A 1990 student painting by British contemporary artist Peter Doig sold at Sotheby's in 2008 for £5.7m and then for $25.9m at Christies New York in 2011. But Doig, Lucien Freud and Damien Hirst are the only contemporary artists among the ten most expensive in the Artnet Price Database, indexed to 1985. The rest are Old Masters."

Given the huge range of art available, spotting a masterpiece is a challenge even for an expert. At the same time, what's perceived as popular can depend on the tastes of the day as much as the quality of work.

4%

The average compound return on art overall, held for

Here's what you need to know before investing in art, according to Allthorpe-Guyton.

What are the potential rewards and expected risks of investing in art?

between five and ten

years

Spectacular gains can be made in art but the adventure is not for the faint-hearted. The art world is fun, glamorous and brings social status – but the risks are big. The market is heterogeneous and asymmetrical; sectors perform differently, prices do not necessarily reflect data and there are still no reliable benchmark indices to assess risk and return. The average compound return on art overall, held for between five and ten years, is just 4%. The market is inefficient, illiquid, unregulated. Transaction, insurance and storage costs are high. Unlike wine and gold, art's value is not intrinsic, so its price is fluid and elusive.

There are no proxy assets; art does not produce an income and navigating the opaque, snobbish, smoke and mirrors world of the dealers, auction houses and art fairs takes nerve, confidence and knowledge – and branded clothes.

Who are the market drivers – the buyers and the sellers?

The art market is small: less than 1% of the works of art in existence is available, worth an estimated $400bn, according to Melanie Gerlis in her book *Art as Investment* (2014). But the art industry has exploded. There are around 23,000 auction houses and 375,000 dealers worldwide, says Gerlis, and more public and private museums. China plans another 1,200.

Art fairs, biennales, independent art agents, curators, critics, and ultra-high-net-worth individuals advised by the private banks, all influence value and price, and drive up the market. According to Gerlis, $197bn of private wealth is invested in art, more than three times the market's annual turnover.

The secondary and tertiary market for blue chip works is dominated by alpha/beta dealers, such as Larry Gagosian in post-war art and Richard Green in Old and Modern Masters, who can restrict or release supply to stabilise prices. The primary market consists of many small galleries on low margins showing new or undiscovered artists. They sell to collectors and investors willing to learn and take smaller risks.

What have been some of the big trends in the market?

The emerging Asian market, especially in Japan, Hong Kong and China, has challenged US and European dominance. The CEO of Chinese insurer, Taikang, Chen Dongsheng, has deep connections to the Chinese art market, and has just taken a 13.5% stake in Sotheby's. China also has more speculators, tycoons and self-insured collectors, who, like Charles Saatchi in the UK, buy in bulk to hedge against exposure and can manipulate the market.

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The market is now global, affected by political and macroeconomic events, and demands as much financial and business nous as aesthetic judgment and art knowledge. New art funds modelled on private equity offered cost-effective, low-risk returns of up to 20%, but half failed after the 2008 crash. A success is The Fine Art Fund Group, which had $100m of funds under management in 2013, and offers a managed art portfolio service to family offices of private old and new wealth advised by private banks.

What are the regulatory and tax considerations when investing in art?

The art market currently lacks even the light regulation of other alternative asset classes, but more regulation is inevitable. Soaring prices, the rise of private treaty sales by auction houses and the stashing of art in unregulated freeports, which store works supposedly in transit, have thrown the spotlight on art and money laundering. Practices such as non-disclosure of sellers' and buyers' identity and misleading auction sales results that include the high buyer's premium of up to 25%, offer little protection to investors.

Tax issues include import tax for works of art bought abroad, capital gains tax and VAT, which varies from state to state and distorts the market – in the EU it is applied only to the margin between purchase and sale price. The EU also applies the resale royalty right or *droit de suite*, which gives artists and their heirs a percentage, with a €12,500 cap, of the profits of resale of works for up to 70 years after the artist's death.

In the UK, exceptional art can be set against inheritance tax and lifetime giving through the 2013 Cultural Gifts Scheme. This offers 30% of the value of a work set against income or capital gains tax to individuals or companies that donate works of art to the nation.

How has the low interest rate environment affected art investment?

With UK rates at an all-time low of 0.25%, it makes sense to view art as capital. Wealth management services are taking on art professionals to meet client demand to include art in their portfolios, but to preserve capital rather than gain yield. Only 6% buy for investment. Art-secured lending is also increasing: the US loan book is worth $13-15bn and US borrowers get to keep and enjoy their art on their walls.

What are the costs of storing art?

The insurance and storage costs depend on the type of art, size, security, climatic controls and location of the collection. Storage costs with a reputable company can include expensive crates for individual works and cost a minimum of £10,000 per annum, or more for collections that occupy more than 30sqm.

What are the pricing and liquidity considerations? Can investors buy and sell with confidence and ease?

Whatever the auction houses claim, art is less liquid than most assets. There are no substitutes in art and pricing is unpredictable, geared to the unique qualities of each work. Collectors traditionally bought and held works for a lifetime, but now there is much more movement. However, investors wanting high returns should think long-term, ten years or more, depending on the market sector. Art takes time to sell; the main auction sales are twice a year. It may be quicker and less nerve-wracking to sell back to the dealer you bought from at an approximate current price, but you may miss out on a bidding war at auction.

Is there a measure of asset class performance and is it reliable and fair?

Auctions count for only 50% of art sold, but provide the only publicly available data. There are art indices but none – not even the most reliable Mei Moses World All Art Index and British Art Market Research (AMR) – are built on full data, dealing only with the alpha level of high-quality Old Masters, and established modern artists. The Artnet database gives records of individual sales and ArtTactic takes readings from industry insiders to gauge performance of contemporary art, but a futures exchange for art does not exist because no one can predict what artists will do next or account for changes in taste.

What's the experience like for holders?

You could buy modern British art in the 1980s for a few hundred pounds, but now prices for the best works fetch upwards of six figures. In the 1990s, contemporary art shot up by over 100%, with huge gains for big names like Hirst and Jeff Koons, but in 2015 the market cooled. Market sectors are prey to cyclical swings in taste. English watercolours bombed after the art prices collapse of 1990, but records were smashed in sales of fine private collections in 2007 and 2010. Adventurist buyers of new art can mitigate risk by seeing a lot of shows and seeking the best advice. Enjoying the art and knowing the artist also brings its own reward.

Meet the expert

Marjorie Allthorpe-Guyton has been the Secretary-General of AICA International since 2014 and President of AICAUK since 2009. She was Director of Visual Arts at the Arts Council England between 1993 and 2006, and editor of *Artscribe International* between 1989 and 1992.

What is the cost of buying/selling art?

Transaction costs at auction are high for both buyers and sellers, between 12 and 25%, although lower deals and longer payment terms are made for specially favoured works and clients. Investors can benefit from long-term relationships with a dealer with a strong art world reputation who will buy back a work or place it for a commission, saving the costs and stress of auction.

The best dealers, or more politely, gallerists, prefer to work with serious collectors who want to learn and to hold works and not ‘flip’ them to make a quick buck.

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