

Planning Considerations for the New Art Collector

As an engineering student, Pierre Chen loved art but his finances didn't allow him to indulge his passion. When he was a sophomore, he scrounged together \$35 to acquire his first piece, a sculpture by a local artist. At the time, that was big money for him.

Fast forward to 1977 when Chen founded electronics components maker Yageo. His new wealth allowed him to snap up works by Asian artists in his native Taiwan and beyond. Chen later switched his collecting focus to Western artists of the late 20th century like Gerhard Richter, Cy Twombly, Willem de Koonig and Peter Doig. Today he is considered one of the top Asian collectors of Western contemporary art. His collection is displayed in museums around the world and he makes headlines by setting price records for the work of artists he champions.

Many famous art collections start small, and like Chen take twists and turns before they settle on a theme or singular focus. According to [Deloitte's Art & Finance report](#), 72% of art collectors buy original art for passion, though they also have an eye toward investment.

As you start your collection, focus on art you love, but also understand the basics of collecting so you're making prudent financial decisions along the way.

Love what you buy

Ask any art expert about how to start collecting and the first thing you'll hear is that they fell in love with the works of a certain artist or style. There's even a saying in art collecting circles, "Buy with your heart, not with your head." Certainly, art has the potential to increase in value, but the initial drive for most collectors is their love of the art.

"A collector has to decide if they are collecting for personal passion or for investment purposes," says Susanna Poon, Director of Philanthropy Services at CTC | myCFO a part of BMO Wealth Management. "The art market can be very volatile, and if you're going to buy art and put in your home, it should be because you really love it."

Most collectors don't dive headlong into collecting. They start small. But those early purchases are the foundation. They may be the building blocks of a cohesive collection or they may simply be the early foray into the market.

"Our clients start with one or two pieces," says Poon. "They build their collections over time. Their collection grows as their wealth grows."

Adds Jim Minich, CTC | myCFO's Managing Director in the Capital Advisory Services practice: "We had a client that started with one Picasso, then they decided to expand their collection to the point where they had one of the biggest private collections of Picassos."

There are an endless number of pieces you could buy on a wide range of subjects, media and prices. But if you want to elevate your art buying to collecting, it's necessary to make a mental shift.

"The best way for new collectors to figure out what they like is to go out and see as much art as possible," says Danna Kay, Art Collection Management Specialist with AIG Private Client Group. AIG is an insurer that provides coverage for art.

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Planning Considerations for the New Art Collector

Once you have discovered the art that speaks to you, how do you then figure out what kind of collection to build? There are several ways to organize a collection. You could focus on just one artist, perhaps branching out to other artists who were influences. Alternately, you could focus on a particular school or style such as the Hudson River School or contemporary Asian artists.

Or you can use your collection to make a social statement. Take for example, British art collector Valeria Napoleone, who only buys art made by women. She has amassed one of the foremost collections of modern women artists. Specifically, Napoleone has set her sights on buying works from emerging female artists and those who are in the middle of their careers rather than established artists who already enjoy a significant following.

“Over the years [collectors] will likely edit their collection, sell or donate pieces and add new ones,” says Kay. “As their tastes and interests change, so too their collection will evolve.”

An art advisor can help you develop your eye and your style. He or she can take you to galleries, auction houses, art fairs like the Frieze, the Venice Biennial and Art Basel and artists’ studios so you can get exposure to different artists, themes and styles. In these early days, there is no pressure to create a singular, guiding mission to the collection.

Consider the Petrucci Family Foundation, a collection of 230 pieces of African American art that’s been on display in at least four museums in the last year, including the Portland Art Museum in Oregon. In 2012, Jim Petrucci, a New Jersey developer, began acquiring pieces of African American artists and African subject matter.

Only years into collecting did Petrucci, working with his art advisor, hone in on his desire to focus solely on African American artists, harking back to his early academic interests as an American history major at Princeton. His senior thesis centered around black and white patrons of African American writers during the Harlem Renaissance. Now the collection is deliberately striving to bring the work of black artists to major museums so that the public can discover these often underrepresented artists.

“As you start collecting more pieces, you get connections to artists or, you might even be able to buy privately so you don’t have to compete with other collectors at auctions,” explains Poon.

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Finding the right price

Like any asset, art goes through speculative periods when its price is greatly inflated. If you are looking for a good deal, focus on artists and styles that are out-of-favor. Post-war and contemporary art has long enjoyed extreme popularity, so it’s hard to unearth a bargain.

But an artist that was once in fashion could come back. And spotting early promise in young artists could pay off when he or she becomes successful. Consider attending graduate student art shows, somewhere dealers and museum curators scout out.

Remember, that when you buy art there are costs involved above the cost of the piece itself.

“It’s also important for new collectors to be aware of the additional expenses that are involved in buying at auction such as the buyer’s premium, taxes, and packing and shipping costs,” explains Kay.

Though there are some exceptions, buying art will generally mean paying sales and use tax. How much depends on where you purchased the pieces and where the pieces are displayed.

Financing art

In 2015 Chinese billionaire Liu Yiqian paid \$170 million for a nude painting by the artist Amedeo Modigliani, the second-highest price ever paid for a painting. But perhaps the most intriguing aspect of the sale was the fact that Yiqian paid for the purchase with his American Express centurion card, earning him enough reward points to allow his family to travel for the rest of their lives.

If you don’t plan to put your art purchase on a credit card, there are other options.

Cash of course is best. Overextending yourself to buy art isn’t a wise move, unless there are deliberate reasons to use leverage. However, there are times when it makes sense to finance a purchase rather than use your own capital. Large financial institutions and private banks provide loans for art purchases.

“They are looking for strong borrowers,” says Minnick, “someone with strong cash flow.”

In other words, financial institutions don’t want you to sell off the piece you are buying in order to repay the loan. On average, banks will finance up to 50% of the value of a piece. Rates can be as low as 3%, which is typically reserved for high net worth individuals who have a substantial portfolio to back up the loan.

In addition, auction houses like Sotheby’s and Christie’s also offer financing at favorable rates if you buy art through them.

Planning Considerations for the New Art Collector

A passion or an investment?

At some point, your collection may change from passion into investment. It's not hard to see why. There are times when a corner of the art market catches fire and investors see spectacular gains. A few years ago, prices for emerging artists like Oscar Murillo and Lucien Smith soared more than 3,000%, the result of "art flippers" entering the market.

But that's not the norm. The Blouin Art Sales Index has posted a long-term return of 10% a year. However, because there are so many variables, that's by no means a guarantee. If anything, that may be an inflated figure, contend [researchers](#) from the Luxembourg School of Finance, the Stanford Graduate School of Business and Erasmus School of Economics. In their analysis, they found that the true long-term returns of art are closer to 6.5% a year. Sales figures are skewed by selection bias. The most valuable pieces come to market more frequently, and tend to command higher prices. Sellers tend to hold back works that may not sell well.

How should art fit into your portfolio? Financial experts like Minich believe it should be viewed along the same lines as other alternative investments, such as real estate or private equity. Art has a [low correlation to other asset classes](#), so it can be a good portfolio diversifier. For example, in 2008, as securities markets worldwide faltered, the art market was flat. It was only in 2009, when the stock market rebounded, that the art market sank.

However, art is not like other investments. It's highly illiquid, so investors may not be able to easily convert their investment into cash if the need arises.

"We don't want the art to become too big of a person's balance sheet because then they become relatively illiquid," says Minich.

The liquidity issue can be offset by using art-secured lending, which allow art owners to access the value of their works without having to sell them.

Make it legal

The next step after picking out your artwork is to obtain the proper documentation. Documentation is essential for authentication and ownership, as well as determining value. Art fraud is rampant, with forgeries and stolen pieces regularly coming to market.

Proper documentation is essential to determining the authenticity of any piece in your budding collection, but even that's not foolproof. The renowned Knoedler Gallery of New York went under in 2011 when it was discovered that it had sold several fakes, many of them for seven figures.

When you purchase a work, you should receive a detailed description of the piece, including dimensions, materials used, type of work and its visual qualities. That helps to establish that the artwork in your possession is indeed the one described in the provenance documents. In addition, it should include title, the date created and the artist.

"You want to know if there is any documentation of the provenance of a piece," says Poon. "It should show the chain of title: it should show every owner, every time it was lent out, whether it was to a private gallery or if it was shown in a museum."

But even with a full list of owners, it's not always easy to determine if there may have been any fraud in the work's history. The issues of ownership could affect its value. When you hire an appraiser he or she will take into account the ownership to determine value. Works whose chain of title is incomplete may not get as high an appraisal as those able to document all previous owners.

Unfortunately, for many pieces—especially older ones—there may never be full documentation. There are likely to be missing pieces in the chain of title.

If any of the previous owners are still alive, you can speak to them about the piece, inquiring about how they came to own it, who the other owners were and where the piece was shown.

The other reason you need full documentation is for tax purposes. With documentation, you have a record of how much you paid for the piece, attorneys' fees, brokers, cost of appraisal and so on.

"All of that can be added to the cost basis," says Poon. "If you sell the piece, you need to know how much gain there was."

Protect your investment

Of course, once you bring a piece you love home, you want to make sure that it's protected. The best way to preserve your artwork is to put it in a box in a darkened, temperature-controlled room. But where is the pleasure of collecting if you do that? There's a delicate balance between keeping your art in optimal conditions and being able to enjoy the work.

Nonetheless, there are a few things to keep in mind.

First, remember that art can get damaged by big temperature swings. Canvases can expand and contract, causing the paint that's on top of them to crack over time. Older paintings are particularly tough since each color is made of different materials and reacts to high and low temperatures differently.

What's more, says Poon, "you don't install art in direct sunlight and you don't install art underneath a bathroom."

Planning Considerations for the New Art Collector

That can get tricky in an apartment building where it's hard to know what types of water fixtures exist in your upstairs neighbor's apartments. Big windows provide a home with a desirable sun-drenched ambiance. But sunlight fades colors because the ultraviolet rays cause bleaching. Textile and watercolors are particularly susceptible to this effect.

Additionally, think carefully about where you plan to place the art work. High traffic areas may not be the best places to install precious artwork. "Do you have young children who like to throw things at the art work?" Poon asks. "You need to take that into consideration."

A professional installer is trained in handling rare and fragile art pieces and can place the art for you. Make sure that you are using the right materials for hanging and displaying the artwork too.

"Take into account the weight of the work, construction of the wall and any regional exposures that might exist such as the potential for an earthquake in California, for example," says Kay. "We see several claims a year for artwork that spontaneously fall from the wall as a result of faulty installation or out hanging hardware."

Accidents happen

Despite your best efforts, however, your art may become damaged nonetheless. Consider what happened to Steve Wynn, the casino magnate and famed art collector. Weeks before Wynn was to sell his painting, Picasso's *La Rêve* in 2006, he was showing off the piece to a group of friends when he gestured wildly and pierced the canvas with his elbow. The sale was off until Wynn paid for professional restoration. (Wynn decided against selling the piece at the time, though he finally parted with it in 2013).

The right insurance policy can protect your piece against theft or damage.

To start, find out what your current homeowner's or renter's insurance policy covers. These policies usually have a dollar limit for how much they are willing to insure. But you may be able to acquire additional coverage by paying a higher premium in order to insure your collection. If you are just starting your collection and you only have one or two pieces that may suffice.

Once you move into multiple, high-value works of art, you'll want to seek out companies that specialize in insuring art. A personal articles

floater is a separate policy specifically for high-value contents.

The advantage of this type of policy is that you can get coverage for much higher dollar amounts and the policies typically cover a broader range of incidents that could result in the damage or theft of the art.

The first step to getting coverage is to get an appraisal. Knowing the value of the art will help you decide how much coverage to obtain. For the appraisal, you'll need the proper documentation discussed earlier. Have on hand the bill of sale, the chain of title and possibly photographs. You might be able to snag a discount from the insurer if you can show that you have a functioning alarm system.

The coverage amount may differ from the retail value of the artwork, however.

"There's the value of the insurance and the value for replacement," explains Tina Milligan, Managing Director with CTC | myCFO. "The current value may be \$20 million, but a replacement might be \$24 million and you need to pay a premium that will help you acquire a similar piece of art."

The replacement value is often higher because it will take time to find another piece of art that's comparable to the one that was stolen or damaged. Due to appreciation and market forces, by the time another Jackson Pollack or William Kentridge comes on the market, the price could be higher than the last appraisal.

To keep up with the changing value of your artwork, appraise your collection periodically and update your insurance coverage.

"You need to be appraising the art with the fluctuations of the market because insurance will only pay for the last appraisal value," says Poon. "If you bought your Picasso 20 years ago, how can the insurance company pay you out properly for it?"

The opposite is also true. If an artist or style is out of favor, its value might drop. In that case, you can insure your piece for less, helping you save money on the premium.

Collecting art can be a gratifying experience that can take you into an exclusive world of auction houses, galleries and artists' studios. There's a lot to learn in the early days of collecting. Being guided by your heart (and your eye) is important, but making the best financial decisions requires you to also think with your head.

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