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The Hedge Funds of the Art World

By Crystal Kim

Art funds do what wealthy collectors have been doing for centuries — build and manage important collections. But the overriding purpose of these funds is to tap the works' long-term financial worth, rather than savor their aesthetic value as they hang on a wall.

Art funds are growing in popularity as a way to get a piece of the frothy and unregulated art market estimated at $56 billion. Last year global inflows to such funds ran at $482 million, up from $32 million in 2008, according to London-based ArtTactic, a market research firm. Investors generally commit a minimum investment, ranging from $50,000 to $500,000, which is locked up for a set period. After every piece in the collection is sold, investors receive their share in the profits.

Art funds are akin to hedge funds, at least when it comes to costs. They typically charge 1% to 3% of assets in annual management fees; at the end of the typical art funds' life, they take 20% of the profits. Remember, too, that there are the underlying costs of acquiring and selling the art —the commissions to dealers and auctioneers—that also whittle away the capital invested in a fund. And there are taxes: Collectibles are taxed at 28%, not the 20% rate applied to long-term capital gains. Unless the fund scores some big wins, it can be an expensive source of cocktail party chatter. The most cost-effective way to invest in art (while also enjoying its aesthetic returns) remains acquiring a portfolio of works directly, in consultation with an art advisor.

The London-based Fine Art Fund Group is a fund operator deserving of a closer look. It's the largest art investment firm, with nearly a quarter billion dollars in assets. Its funds have multiple 10-year, five-year, and shorter-term maturities devoted to major art periods: post-war and contemporary, modern, impressionist and old masters. Fine Art's vehicles charge 2% annually. After investors get a 6% annual return, the fund sponsor gets another 20% of the profits.

Philip Hoffman, founder of the Fine Art Fund Group and former Christie's finance director, attributes the firm's "moderate success" to his teams' dual sense of artistic relevance and finance. "The recurring criticism of art funds is that they are run by an art dealer or by an ex-banker," he says. "The ex-banker sees art as a passion or a hobby after his stint at Merrill Lynch, and the art dealer sees it as a way of dumping unwanted stock."

Hoffman says he is neither and that his art background helped him pick 18 of the best dedicated-sector experts on his team, including Impressionists & Modern art advisor James Roundell, formerly of Christie's; Ian Dunlop, who hails from Citibank Private Bank's Art Advisory

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service in London; and prominent figures such as Ivor Braka, the leading Francis Bacon and Lucien Freud dealer as well as Thomas Dane, who has represented artists like London-born Steve McQueen.

Conflicts of interest? Dealer's contracts state they aren't allowed to sell their stock to the funds. A three tier process to approve purchases, including a review by a due diligence team, and a final sign-off from Hoffman, are apparently designed to prevent conflicts. The firm deals only in A-grade works from blue-chip artists averaging $1 million per transaction and rarely buys anything for under $200,000.

Fine Art purchased Frank Auerbach's *Mornington Crescent* in 2005 after Hoffman's experts studied the figurative painter for a decade. Auerbach, who ran in the same "London School" circuit as Francis Bacon and Lucien Freud, kept a low profile. The reclusive artist's works, which were then selling at $500,000-$800,000, about a tenth the price of Bacon's. So when the right Auerbach came along, the firm bought it for $1.1 million and a year later, sold it for $2.3 million.

By kind permission of the Gala-Salvador Dali Foundation, Spain © Glenn Brown

In 2007, Hoffman's group also purchased for $1.1 million, Glenn Brown's *Dalí-Christ 1992*, previously in the Saatchi Collection. The group sold it in mid-2010 for 60% more, setting an artist record at $1.76 million. The group did better with Peter Doig's *Iron Hill*, which sold for $1.8 million in 2006, a 107% profit just one year after its purchase. Doig's contemporary landscape evokes a sort of Hopper-like nostalgia tinged with a hint of despair.

With the group's first fund set to mature in two to five years, it is impossible to get a clear picture of its total returns. Hoffman claims that for every work the firm has lost money on, 19 works have produced profits. They did take a hit on a work by a Chinese contemporary artist, for example; the firm bought it for $220,000 and sold it last year for $200,000. The loss, Hoffman says, was because the artist overproduced and saturated the market after the fund made its original purchase.

Although none of Fine Art's funds currently is open to investors, about a dozen other art funds currently fundraising in Europe and the U.S., according to Anders Petterson, ArtTactic's founder and managing director. The Collectors Fund based in Kansas City, Mo., is raising money for its second fund, and the Luxembourg-based Art Collection fund is on its first round. Smaller, they respectively specialize in mid-tier American masters of the 20th century and modern, contemporary, and tribal art.

Art economist Dr. Clare McAndrew, who writes the annual TEFAF Art Market report, believes that art funds are likely to stick around. "I think people are realizing that it's a valuable form of investment or, at the very least, a way to hold wealth with some security for the longer term," she says.

However, McAndrew cautions against funds with short-term maturities, which she deems inappropriate for the art market. "One particular fund that failed during the 2008 crash, tried to sell a lot of mid-level contemporary art at the worst possible time," she says, "The firm was overleveraged, couldn't pay creditors and was saddled with a lot of art assets."

That's a sobering reminder to tread cautiously in this space.

Art, dali, Salvador Dali, Spain, Spanish Art, Wealth Management

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JUNE 14, 2013 7:48 P.M.

Roopa Dudley wrote:

Clearly a good reason to buy ART – lots of it and support your local Artists. It is good for us Artists, it creates good ambiance for your home or work and it is good investment too. A win win situation for us all.

JULY 2, 2013 9:03 P.M.

Anonymous wrote:

I'm surprised the Dali-Christ went for only $1.76 min. Hmm.

In a very casual and unconscious way I guess I have a lot of experience and knowkedge in re to Art. But have never gotten too serious about it. I'm still hanging back and watching. What turns me off is the histrionics and drama among the galleries, critics, artists, fans and collectors and on top of that how stuff is valuated and sold: A lot of it is nonsense. The nonsense is why the real talent in the digital realm that's young and has money from their start ups is not buying art or bothering with the whole game. I would think it must just burn artists and dealers to see a twenty something geek sell their start up for hundreds of millions if not billions. Hmm. Talent wise there's a new star system. Once you get it. Anybody can do what most artists do today. That's the problem. So I do support the older work as an investment. Hopefully things will return to something…

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