

Fine Art and Collectibles



BRAEBURN
FAMILY OFFICE

Fine art and collectibles are an investment and legacy vehicle opportunity for wealthy individuals and families. When a family allocates several hundred thousand dollars to acquire art and other collectables, there is limited need for a collecting strategy. However, when the monetary commitment exceeds several million dollars, it is prudent to develop a comprehensive strategy and discipline. The strategy must address acquisition, storage/display, insurance, maintenance, disposition, legacy, and of course taxes.

Hoping to discover a manuscript of James Joyce's "Ulysses" at the neighborhood garage sale or unearthing a 1957 Gullwing Mercedes 300SL in a relative's termite consumed barn upon their passing is not a strategy....it is a needle in a pile of needles.

What are collectibles and why are they potential investments? Merriam-Webster defines "Collectible" as "an object that is collected by fanciers". People collect what they "fancy". Wealthy individuals and families collect with greater resources and (hopefully) prudent strategies.

Collectibles include fine art, automobiles, books/manuscripts, jewelry/precious stones, coins/stamps, Stradivarius violins, and fine wine. Within this diverse universe there is a common denominator of value creation: rarity. When a desired object is in limited supply, value is created.

As noted above; people collect what they fancy and have an interest. For the multi-million-dollar collector this journey takes on a more serious dynamic. People who enjoy art collect paintings, those who love cars acquire them, lovers of letters seek out manuscripts and first editions, and connoisseurs of fermented grape juice; fine wine (or so they hope).

Develop a Strategy

David Rockefeller passed away in 2017. He and his wife Peggy amassed a collection of art unsurpassed in the universe of private collectors. Their estate retained Christie's to auction the collection with the proceeds passing to twelve non-profit organizations. When the auction concluded in the late spring of 2018 collectors paid in excess of \$832 million for the collection. What created such value? Surely the Rockefeller name contributed, but a

lifetime of collecting with a disciplined, well curated strategy was the major reason the collection attained stratospheric value. The Rockefeller strategy was straightforward: they bought what they *both* liked, stayed within the Impressionist, Post-Impressionist, and Modern genres, and sought the best work of each artist. Simple. (The auction included furniture and porcelain)

The creation and disciplined execution of a collecting strategy yields numerous benefits. There is a small troupe of exceptional art consultants that bring tangible value to a family assembling a collection. Their mandate begins with a thorough evaluation of interests, resources, and long-term plans. The fruits of this process is a strategy and disciplined action plan.

Pursuing a focused area of interest allows resources to be allocated with the greatest leverage. In addition to monetary, resources include knowledge, and third-party experts. As a collector commits to a specific genre their increased knowledge, experience, and relationships is of great value. Collectors who are buyers of specific objects and genres develop valuable relationships with dealers, auction houses, and museum curators as well as the posse of indispensable third-party professionals (lawyers, appraisers, and risk managers). These parties are all resources for acquisition, sale and additional knowledge.

Acquisition and Sale

Fine art and collectables are acquired in numerous ways. Auctions, galleries and dealers, direct sales from owners, the artists/creators themselves, and the tried and true means of inheritance are all common. Supporting emerging artists through acquiring their work may yield financial as well as emotional benefits. Peggy Guggenheim reportedly “discovered” Jackson Pollock in 1943 while visiting another artist. She provided him a stipend and one-man show at her Art of the Century Gallery in New York. Her modest investment in him was a far cry from the approximate \$200mln sale price realized in 2015 by the David Geffen Foundation when they sold his Number 17A. The parallel in financial asset investment may be investing in start-up ventures. Of course, it helps to have the patronage of a Guggenheim, Rockefeller, or Geffen just as the endorsement of Warren Buffett brings instant platinum patina in publicly traded security markets.

Christie's, Sotheby's, and Bonham's among many global auction houses provide buyers and sellers an efficient platform to facilitate transactions. In addition to fine art; wine, automobiles, coins, watches, whiskey, antique furnishings, and photography pass through their auction portal.

Perhaps the most important aspect of the acquisition process is the establishment of provenance. Provenance is the record of ownership used to establish authenticity and quality. Not surprising; with the explosion of value across the collectables spectrum there has been a meteoric rise in fraud.

Investing in financial assets requires a disciplined due-diligence research process. The same dynamic holds with collectables. Recent high-profile frauds include the Knoedler Gallery in New York City and Bill Koch's well-documented experience with counterfeit bottles of wine including several purportedly from Thomas Jefferson's estate.

The Knoedler Gallery fraud is particularly instructive as it involves a gallery founded in 1846. Knoedler was one of New York City's most respected galleries. The Gallery was shuttered when they became the center of an \$80mln fraud. Collectors relied on the reputation of the gallery instead of doing their own due-diligence. Ronald Reagan stated: "trust but verify". Truer counsel could not be given to characterize acquisitions within the collectable investment universe.

Whether fine art, wine, or other valuable collectables; buyers must understand the provenance of their acquisition targets. This may require the retention of forensic experts. Many art frauds have been exposed through the analysis of the chemical base of the pigments used in the paint. The deceit is revealed because the chemicals present in the pigment did not exist at the time the painting was created. Counterfeit bottles of wine have been identified through the chemicals present in their labels that are inconsistent with those of vintage and producer. Collector investors are wise to employ the tools of scientific advancement to expose fraud and protect themselves.

Exhibition and Storage

The exhibition and storage of collectables presents subtle and important challenges that must be prudently addressed and mitigated. Whether automobiles, fine art, wine, jewelry, or antique furniture; suitable display and storage is paramount in preserving (and in the case of wine, perhaps enhancing) value. With the possible exception of jewelry, the natural elements of humidity, temperature, and light are the enemy of collectables.

For a collection of art installed throughout a home; best practices demand an assessment of the numerous points of environmental intersection prior to installation. This includes the obvious no-no of placing art in direct contact with air flowing from vents and direct sunlight as well as a comprehensive examination of all wall surfaces through infrared thermography and imaging to identify excessive heat and chill created by ducts and electrical systems. Enormous damage may be inflicted on paintings installed on walls that are transmitting heat and cold from behind the surface.

Wine presents a unique storage/display challenge. Wine is traditionally stored in a "cave" beneath the home and retrieved for consumption. Caves were generally designed and built for function (maintaining a steady temperature of 55 – 58 degrees Fahrenheit) rather than as showcases. During the past several decades that dynamic has evolved as more collectors invest in caves providing a visual "wow!" as well as maintaining appropriate temperature and humidity levels. The glass enclosure that allows the spectacular view into the Bacchanal retreat from the dining room must be properly sealed and maintained. Display cases and shelving should cradle bottles in such a way that the wine remains in constant contact with the cork. Imagine the tragedy of a 1945 Romanee Conti bottle destroyed because it was presented upright allowing air to reach the wine because the cork had dried.....yikes.... a \$500,000 bottle of vinegar (designer salad dressing).

In regions where the earth is occasionally unsettled, provisions must be made to prevent earthquake damage. A solution as simple as a specialty security leash attached to a painting, sculpture, or bottle of wine may prevent heartbreaking and expensive loss.

Collectors of automobiles face the challenge of space management. The largest of home garages are generally inadequate to safely corral a collection beyond eight/ten automobiles. The solution for collectors has been to lease, buy, or build a commercial garage/warehouse. Jay Leno's magnificent collection of cars is safeguarded and on occasion showcased in his commercial warehouse/garage. In addition to storage and exhibition, the warehouse allows for full service bay installation so the collection may be serviced on site. This dynamic provides additional security and custodial control.

Secure storage is a primary concern of collectors of jewelry and fine stones. The installation of a sophisticated safe as well as security system for the entire home is of paramount importance.

The specialists and curators at Chubb, Aon, Sotheby's, Christie's, Bonham's, and numerous museums are invaluable resources to assist collectors with exhibition and storage dynamics.

Insurance

Insuring multi-million-dollar collections of fine art and collectables is a dynamic of exceptional importance. While a collector may have extensive homeowner insurance, it is prudent to engage an insurance firm that specializes in fine art and collectables.

As with all contracts (an insurance policy is contract between policy holder and insurer) the details are of paramount importance. With fine art and collectables, it is prudent to secure not only a Property Policy but also explore the inclusion of a Title Policy. Title Policies insure against defective title of the piece. As has been noted, the importance of clean provenance cannot be understated. For the collector with pieces of exceptional value it is foolish to not consider Title Insurance. The quest to reunite art with families who were victims of World War II theft continues and remains a core of provenance dynamics.

Property Insurance insures against damage and theft. However, the specific details of the coverage must be carefully vetted and negotiated. Does the coverage include accidents, fire and water damage, natural disasters, transit

to temporary exhibitions if the piece(s) is loaned occasionally? Insurance should cover replacement cost of the piece, not simply the cost of purchase. Does the contract cover the expense of restoration and the collateral lost value? Replacement value policies require regular appraisals. The appraiser should be aware the appraisal is for insurance purposes.

Insurance strategies should encompass the collection in totality as well as individual pieces that may require carve-out specialty coverage.

Fine art and collectables insurance specialists are excellent resources beyond coverage policies. The best provide risk management strategies focused on display, security, and environmental management. Through their universe they may also be resources for acquisition and sale of pieces and collections.

On to the Next Generation or...

Owning and enjoying valuable collectables requires a long-term strategy. What are the plans for the collection beyond the current generation? Options include donating to a museum, library, school, selling all or part, or bequeathing to succeeding generation(s). A combination of these dynamics is a common solution. Whatever the decision; it is of paramount importance the strategy is established, negotiated, and executed during the collector's lifetime and not left as a surprise during estate settlement.

Many collectors have a vision of walking into the Metropolitan Museum of Art and gazing upon "their" art displayed as "A Gift of Jack and Jill Collector". A great vision but in most cases a dream unlikely to be fulfilled. Major museums and libraries have more art than they have space and walls to display. Philharmonic orchestras however are eager beneficiaries of the collectors of Stradivarius and Guarneri violins and cellos. Owners of these magnificent instruments commonly lend/gift to orchestras and exceptional musicians.

Institutions prize one genre of gift above all others: cash. It is not uncommon for an institution to accept a gift of fine art and sell the piece(s). If the collection does not fold into their strategy they will sell (or trade) and pursue strategic acquisitions with the net cash. Note that they too have an investment/collecting strategy which includes deaccession protocols that

allow for the culling of the collection. Major gifts must be negotiated in advance, so terms of the transaction are clearly defined in a contract between the institution and donor. Another potential wrinkle is an insistence by many institutions that a donation in kind must travel with a cash gift. The cash gift covers the storage, maintenance, and curatorial expenses of the collection.

Selling a collection may take several paths. A collector with a significant collection will have relationships within the community that are resources for selling assets. A direct sale to a private collector or gallery may be an efficient and confidential avenue. The party that brings the transaction to a close will appropriately expect a fee paid by the seller. Advantages of this dynamic include privacy and perhaps less expense. A noteworthy example of private party transactions is the secondary market for California's Screaming Eagle wine. The wine is released through a very limited list of long-time collectors. A number of these individuals immediately re-sell their allocation to retail wine stores at a significant mark-up.

Selling a collection or individual asset through an auction house is common practice. The auction house charges both the seller and buyer a fee. Advantages of the auction house dynamic include a wide audience of buyers, the potential of aggressive bidding driving prices to greater levels, and the marketing of the collection by the auction house. If privacy is a serious consideration this may be a less attractive strategy.

For all sale dynamics it is of paramount importance the seller be able to provide provenance, and evidence of proper storage and maintenance. As noted above provenance demonstrates the trail of ownership and legitimacy of the collection/item. Valuation will be negatively impacted where provenance doubt exists. This is a major reason a disciplined and meticulous purchase protocol is required.

Taxes

As with all assets of significant value, tax strategy must be considered from the onset (Contingent on tax situs of collector/investor). Whether gifting to a museum or subsequent generations of heirs; valuation is a central aspect of the dynamic. While the initial cost basis of the item is established upon

acquisition, the trickier component is establishing the tax value of a lifetime gift to an institution or heir(s), or part of an estate settlement. For collectors with a U.S. tax presence, the Internal Revenue Service ("IRS") has established a process to assist taxpayers in their efforts to accurately determine valuation for estate planning and gift purposes. The IRS created the Commissioner's Art Advisory Panel ("Panel") in 1968 as part of Art Appraisal Services. The Panel provides value recommendations regarding the acceptability of tangible personal property appraisals taxpayers submit to support the fair market value claimed on the wide range of art and collectables involved in income, estate, and gift tax returns. The Panel is comprised of 18-20 professionals and meets semi-annually. The professionals are museum curators, academics, and gallery owners/dealers. Meetings and specific recommendations of the Panel are confidential to protect the identity of the taxpayers.

When a tax return selected for audit includes an appraisal of a single work of art/collectable valued in excess of \$50,000, the case is referred to Art Appraisal Services and may be sent to the Panel for a valuation recommendation. Alternatively; a taxpayer may proactively engage the Panel in anticipation of a filing to receive valuation guidance. The taxpayer will pay a fee for this accommodation.

During fiscal 2017 the Panel reviewed 365 items on 66 taxpayer filings. Taxpayers claimed a value of approximately \$205,400,000. The Panel recommended adjustments (increased value) totaling approximately \$28,200,000.

Each family enjoys circumstances unique to them. Tax attorneys and CPA's are appropriately part of the prudent collection tax strategy and should be part of the strategic planning process..

Summary

Collecting art and collectables may be financially rewarding as well as contribute to the multi-generational legacy of a family. Through a well-researched, disciplined, and focused strategy, the success of a collection may be enhanced and leveraged to the benefit of many generations and cultural institution beneficiaries.

