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# PERSPECTIVES

UNLOCKING LIQUIDITY  
THROUGH FINE ART  
APPRAISAL AND LENDING

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Our perspectives feature the viewpoints of our subject matter experts on current topics and emerging trends.

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## From Canvas to Capital: The Rise of Art-Backed Lending

It is widely understood that fine art collectors frequently identify investment as a primary motivation for acquiring fine art. Considering the fluctuating financial markets and prevailing global uncertainties, many fine art collectors are actively seeking innovative strategies to alleviate financial pressures by unlocking liquidity. A relatively recent solution provided by numerous prominent financial institutions that is growing in popularity is the offering of collateral loans secured by fine art. These loans enable high-net-worth (HNW) individuals and institutions to secure financing against their fine art collections while allowing the artworks to remain on display in their residences and/or businesses. Ultimately, these loans empower collectors to unlock the liquidity of their fine art collections without selling the artworks.

## How Fine Art Is Valued for Lending

### The Role of Appraisal in Fine Art Lending

Fine art appraisal is a critical element in the collateral loan process. Although the word “appraisal” is used in everyday language, it is defined by the Uniform Standards of Professional Appraisal Practice (USPAP) as “the act or process of developing an opinion of value.” The appraisal itself is numerically expressed, and in the case of collateral loan appraisals, it is communicated as a single value for each work of art in the collateral pool. This value is established through comprehensive market research, including the identification of comparable artworks and analysis of relevant sales data, and the

key stakeholders for a fine art appraisal for collateral loan purposes are the lender and the collector.

### The Mechanics of Art Valuation for Collateral Loans

#### *Why Fair Market Value Matters in Art-Backed Lending*

Collateral loan appraisals most commonly report the fair market value of each artwork in the collateral pool, as opposed to the retail replacement value. The term “fair market value” adheres to the IRS definition as stated in the Treasury Regulation Sections 1.170A-1(c)(2) which is “the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.” When using auction results, the fair market value also accounts for the buyer’s premium. A buyer’s premium is a percentage of the final hammer price (or winning bid) at auction that is applied to the final sale price. Conversely, when using retail sales data, the fair market value includes any discounts extended by the gallery.

In contrast, “retail replacement value” is defined as the highest amount in terms of US dollars that would be required to replace a property with another of similar age, quality, origin, appearance, provenance, and condition within a reasonable length of time in an appropriate and relevant market. When applicable, commissions and/or premiums are included in this value. Put more simply, the retail replacement value reports the highest value an insurance company would need to secure to replace the object with something comparable in a timely manner on a particular date (also known as the effective valuation date).

The fair market value is the amount that the artwork would hypothetically sell for as of the

effective valuation date, inclusive of discounts. Therefore, the fair market value is typically less than the retail replacement value. Lending institutions require fair market value, rather than retail replacement value, because in the event of default, they can only expect to recover the fair market value through resale.

### ***How Artist Reputation and Demand Drive Art Valuation***

Several factors can impact an artwork's fair market value. One such factor is the artist's reputation and market demand for their work. For instance, the French Impressionist Claude Monet is synonymous with top-tier artists. His work is held in many world-renowned museum collections internationally and is recognizable to even those outside of the art world. Seminal works by Claude Monet are rarely available for purchase and, because the artist passed away nearly a century ago, supply is limited. Significant works by Claude Monet are unlikely to depreciate in value over time as they will continue to be desirable to collectors.

The market for living artists is more complex. Artists fall in and out of favor based on trends, and the art world can be fickle. Artists can experience market declines related to controversy in their personal lives and are vulnerable to changes in culture and taste. Notably, as long as an artist continues to produce work, their oeuvre expands, thereby increasing the overall supply. However, artists included in blue-chip gallery rosters are more protected from market volatility. These galleries set pricing, vet potential collectors, and control the flow of inventory. Blue-chip galleries such as Gagosian often manage lengthy waitlists for a single artist's work. As such, the supply is low while demand is high, resulting in a strong and stable market for the artist. High net worth collectors routinely transact in the blue-chip gallery sphere to secure their investments and mitigate the risk of an ever-changing financial and cultural landscape.

### ***Why Documentation Matters: Provenance and Ownership Verification***

Another critical element in the appraisal process is the collection of pertinent documentation related to the acquisition of each artwork. The collector typically provides this information at the onset of the appraisal process as it is crucial to confirm both authenticity and ownership. It is important to note that an appraiser is not an authenticator; however, the appraiser must perform their due diligence to be certain that the authenticity of a particular object is not in question. Additionally, the provenance of an artwork can be a value driver, as works previously owned by a prominent collector or institution are often more desirable than works hailing from less established collections. Further, a single-collection provenance for a significant century-old painting is more desirable in the market than one that appears for sale at auction routinely and has changed ownership multiple times. Provenance and authenticity are key components in accurate appraisals.

### ***The Impact of Preservation and Wear on Appraised Value***

The condition of an object also impacts its value. A work that has experienced damage and has been restored is less desirable to collectors than an object that is in pristine condition and has never been restored. Importantly, the market will accept a certain level of wear given the object's age and material. Apparent craquelure on the surface of a painting executed a century ago is common, while blemishes in the substrate will have a more negative impact on an object's overall value.

### ***Auction Trends as Indicators of Market Strength***

The auction market also has a significant impact on an artist's individual market overall. Robust sales at auction indicate demand, and galleries will increase the retail prices for that artist's work in concert with robust sell-through rates



and high sale prices. Likewise, when a notable work passes at auction, or fails to sell, this can depress the artist's overall market. Given the influential shifts of the auction market, it is necessary to have a qualified appraiser analyze sales data.

### Key Stages in Fine Art Collateral Appraisal

Each financial institution approaches fine art collateral appraisals with its own unique provisions; however, several common requirements tend to emerge across the board. Generally, the number of artworks involved is fewer than 50, and each institution establishes a minimum value threshold for individual pieces, typically within the six-figure range. It is essential for the collection to exhibit diversity, ensuring that the artworks securing the loan are not solely attributed to a single artist or confined to a specific artistic period. This strategy serves to mitigate value risk; should the market for a particular artist decline or if a specific category of artwork experiences a downturn during the loan term, the overall risk to value is somewhat alleviated. Typically, the loan amount is set at 50% of the total fair market value of the collection.

Once the individual items within the collection have been approved, the financial institution requires a fair market value appraisal as of the loan term start date. Appraisers who perform these appraisals are commonly held to the same standards that the IRS sets forth in defining a qualified appraiser. The appraisers must be professional in that they regularly prepare appraisals for which they are paid. Additionally, the appraisers cannot be an "excluded" individual, meaning that they have not been disqualified by the IRS from preparing appraisals. Further, they must provide independent valuation outside of third-party influences, retain no outside interest in the subject property other than an accurate and professional value,

contract for appraisal work only within their professional area of expertise, and reach objective value conclusions by considering all factors in appraisal standards. Such appraisers are understood to utilize the highest standards of connoisseurship in examining and documenting the property. Additionally, the appraisers are required to have active membership within at least one professional appraisal organization, such as the Appraisers Association of America or the American Society of Appraisers. Appraisal organizations such as these emphasize the importance of credible appraisal results. Further, these appraisal reports are required to be prepared in conformity with the most recent iteration of the Uniform Standards of Professional Appraisal Practice (USPAP), written by the Appraisal Standards Board of The Appraisal Foundation (TAF) in Washington, D.C. The Appraisal Foundation is a congressionally sanctioned, not-for-profit organization, established in 1987 and dedicated to the advancement of professional valuation for appraisers and users of appraisal services to ensure public trust in the work performed by appraisers.

Typically, the appraiser conducts a thorough personal inspection and inventory of each artwork within the collateral pool. They assess the quality and condition of each piece, documenting any defects or condition issues that deviate from the commonly accepted standards for the item's age, type, and material. Additionally, the appraiser may identify any security concerns, such as the proximity of artworks to open fireplaces, beneath sprinkler outlets, and other potential hazards that could threaten the integrity of the artworks throughout the loan term. In certain cases, the artworks in the collateral pool are stored in a secure fine art storage facility for the duration of the loan, thereby ensuring their safekeeping.

The appraiser conducts thorough research and prepares the appraisal report with careful consideration of the auction market. This focus

is justified for two primary reasons. First, the auction market is publicly accessible, and the reported sale prices are readily available. Second, if a collector defaults on their loan, the financial institution may need to seize the collection, which would likely be sold through a prominent auction house to recover funds. Consequently, it is imperative that the artworks within the collateral pool possess a robust market presence at auction. Although default rates on loans secured by fine art are notably low, the appraiser must remain cognizant of this factor while undertaking their research and drafting the appraisal report.

## Timing Matters: When to Reappraise Collateralized Art

It is important that collections are reappraised periodically to account for market fluctuations. While it is advisable to have collections appraised every two to three years for insurance purposes, collateral loans are typically reappraised every loan term cycle. The reappraisal accounts for market volatility, charting the highs and lows that are typical in the art market.

## Understanding the Structure of Art-Backed Loans

### Considering Liquidity, Marketability, and Risk Management During Loan Request Evaluations

The loan-to-value (LTV) ratio is a key metric, typically ranging from 40% to 60% of the appraised value. The supply, demand, and liquidity profile of an artwork is a significant factor considered by lending institutions when determining the LTV and overarching loan

terms. Lending institutions may also consider the borrower's financial standing. This practice is more common in recourse loans where personal credit history and additional assets may be required as a guarantee.

Each financial institution has their own requirements concerning the safekeeping of the art collection over the course of the loan term. Typically, the artworks are required to remain in the location in which they were inspected by the appraiser. This minimizes risks related to shipping and incidental damage during the reinstallation of an artwork. In any event, the collection must be insured during the loan period.

## A Step-by-Step Guide to Securing a Loan with Fine Art

The loan process starts with a submission of a professional appraisal of the artwork and a formal loan application. Lenders then conduct due diligence to verify ownership, check for legal claims, and confirm authenticity through an in-house or third-party appraiser. The lender then undertakes the loan underwriting and risk assessment. This step involves a comprehensive evaluation of the artwork's appraised value, the borrower's financial profile (where applicable), and the overall risk exposure to assign a LTV ratio. Higher LTV ratios are typically offered for blue-chip art with strong demand, whereas lesser-known or illiquid pieces may receive more conservative terms. The lending institution must also consider whether the loan will be recourse or non-recourse, which determines whether the borrower's personal assets are at risk in the event of default.

If the loan is accepted, a formal loan offer is extended which outlines the terms and conditions, including the interest rate,

repayment schedule, and collateral custody requirements. Depending on the nature of the loan or the rarity of the artwork, the lending institution may require the art to be stored in a climate-controlled facility to ensure the safety and longevity of it for the term of the loan. When the borrower accepts, legal agreements are executed to secure the lender's interest in the artwork through a UCC-1 filing.

Throughout the loan term, the artwork must be insured for its full value, and specific lending institutions may require periodic reappraisals to ensure the collateral remains adequate. This structured process ensures that both parties are protected while allowing the borrower to unlock liquidity without having to sell their prized fine art collections.

## What Borrowers Need to Know Before Using Art as Collateral

While art-backed financing offers an alternative way for borrowers to access liquidity, it does not come without significant responsibilities and risk for the borrower. For example, if the artwork remains in the borrower's possession through the life of the loan, they must adhere to strict storage and insurance requirements. These requirements are typically set by the lending institution and are often non-negotiable. Damage, loss, or deterioration of the artwork's condition may reduce its value and jeopardize the loan agreements. The borrower must also ensure that the artwork remains free of legal disputes or encumbrances throughout the life of the loan.

Arguably the largest risk for borrowers is the potential loss of artwork in the event of default. If the borrower fails to meet repayment obligations or violates the loan terms, the lender has the legal right to seize and sell the artwork to recover outstanding

loan balances. Borrowers with emotional or historical ties to their pieces can find this to be devastating. In the event of default, borrowers may also face reputational risks, especially in high-profile collectors or well-known collections. For borrowers under terms of recourse loans, there is also a risk of personal financial exposure beyond the artwork itself. Borrowers must consider the implications of using fine art as collateral and assess their ability to meet loan terms when determining if this type of financing is right for them.

## Lender Considerations and Risk Management in Art-Backed Loans

The risks and rewards of art-backed financing are not limited to the borrower. Lenders view art-backed financing as both a unique opportunity and an opportunity with notable risks. These loans allow lenders to tap into a niche and ever-growing market of high-net-worth individuals owning valuable, often appreciating, assets. Since art is a non-correlated asset, longevity and stability of the loan can be expected even with unforeseen economic downturns. Moreover, these loan types often carry a higher interest rate than traditional ones, marketing attractive returns. Private banks and fine art auction houses offering art-backed loans can expect a deepened client relationship, expanding their suite of wealth management services. The old saying, "high reward often comes with high risk" applies here—lending institutions should carefully consider the risks when determining if this niche market is suitable for their business.

The largest hurdle faced in this market is the illiquidity of the art. The art market is niche, making it difficult to sell artwork quickly or at full value in the event of borrower default. The risk of forgery, misattribution, or disputed

ownership may undermine the value of the art used as collateral. The viability of the art, in the event of damage, theft, or deterioration, even with proper storage and insurance is ever-present. Lenders must consider investing in specialized expertise, conduct vigorous due diligence, and help ensure the security of the artwork. Despite the large risks, many lenders see art-backed lending as a strategic and profitable niche, especially when undertaken with hardy risk controls and legal safeguards.

## How Art-Backed Lending Works in Practice

Art-backed financing has proven successful for several auction houses and/or dealers; however, auction houses are only an option for collectors who are willing to tolerate their collection being subject to the public eye. Said differently, the appraisal services provided by auction houses can create challenges for HNW individuals who value their own privacy and the privacy of their collection. Many HNW individuals are reticent to involve dealers or auction houses in the appraisal process, fearing that disclosure of their holdings could lead to persistent sales solicitations or pressure to consign works. In these cases, collectors much prefer to engage independent, accredited appraisers who do not have an interest in selling the artwork or collection and who may also have experience in economic damage valuations and/or [high-value asset appraisals](#). As previously discussed in more detail, independent and unbiased appraisers aim to provide objective appraisal results, while protecting the collector's privacy at the same time. The use of disinterested appraisers is especially critical in asset-backed lending, where the integrity of the appraisal directly impacts the terms of the loan and the collector's financial strategy.

Outside of historic auction houses that specialize in fine art sales, private banks have integrated fine art financing into their broader wealth management services. These services offer loans to HNW individuals who wish to access liquidity while maintaining possession of their art portfolios. Art-backed lenders have noted the nuances of art-backed lending transactions and attribute success to vigorous appraisals and in-depth legal due diligence, among other things. Art-backed lenders also highlight the importance of understanding the nuances of the art market which include the artist's reputation, provenance, and market demand. Additionally, art-backed lenders explore hedging strategies to mitigate negative market fluctuations, emphasizing the intricacies of managing art-backed loans.

## Conclusion & How Qualified Art Appraisers Can Help

Art-backed financing is an innovative and increasingly popular type of asset-backed lending where fine art is used as collateral to secure financing. These loans offer unique opportunities for investors to unlock liquidity without selling their artwork. Lending institutions evaluate several factors before approving these types of loans such as the artwork's provenance, authenticity, and marketability. For collectors considering an art-backed loan, it is important to assess whether your collection meets the standard qualifications of diversity and liquidity. As such, it is best to meet with one's own financial institution to learn about their specific requirements.

For clients requiring assistance with [estate or trust valuations](#), a firm employing qualified art appraisers and other experts can provide specialized valuation services that

complement these wealth management strategies. Art-backed lenders have noted the nuances of art-backed lending transactions and attribute success to—among other factors—vigorous appraisals and in-depth legal due diligence.

## Acknowledgments

We would like to thank our colleagues Amanda McConaha, Michael Alexander, and Dalton Campbell for providing insight and expertise that greatly assisted this research.

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