

2018

The AAART Fund

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Sotheby's Institute of Art

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THE AAART FUND

BUSINESS PLAN – DECEMBER 2018



Nate Lowman, *Memory Quilt for a Large Ball*, 2017.
© Nate Lowman, courtesy of Gagosian.

MASTER PROJECT BY JILL JONGEN

Sotheby's INSTITUTE OF ART



Master Project submitted to the faculty at
Sotheby's Institute of Art – New York
in partial fulfillment of the requirements
for the degree of MA in Art Business.

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EXECUTIVE SUMMARY

Art is no longer only perceived as an “investment of passion”. Rather, art constitutes a viable alternative financial asset class that can be exploited through strategic trading. Due to the lower volatility and lesser correlation with traditional assets, holding art in an investment portfolio offers diversification benefits that will maintain returns while reducing risk. However, acquiring the “right” artworks, that is, the ones that will appreciate in value, can be pricey and risky. Investors can overcome these two challenges through participation in pooled art investments such as THE AAART FUND.

THE AAART FUND, located in New York City, is a privately offered investment fund that aims to generate returns through the acquisition and disposition of contemporary American artworks. Investors, who become shareholders of the fund, are offered access to the art market through a diversified art portfolio. The fund employs a traditional buy-and hold strategy with a long-term investment horizon of 10 years.

THE AAART FUND’s investment strategy is focused on contemporary American art, as this genre seems to offer the most interesting and lucrative investment opportunities. Only the highest quality of artworks will be selected for the fund. Within this rather broad art category, THE AAART FUND will also allocate part of the portfolio to African American art to take advantage of the recently discovered interest in this art category. African American art is thus a special niche in the region-specific investment strategy, which differentiates THE AAART FUND from other existing art funds.

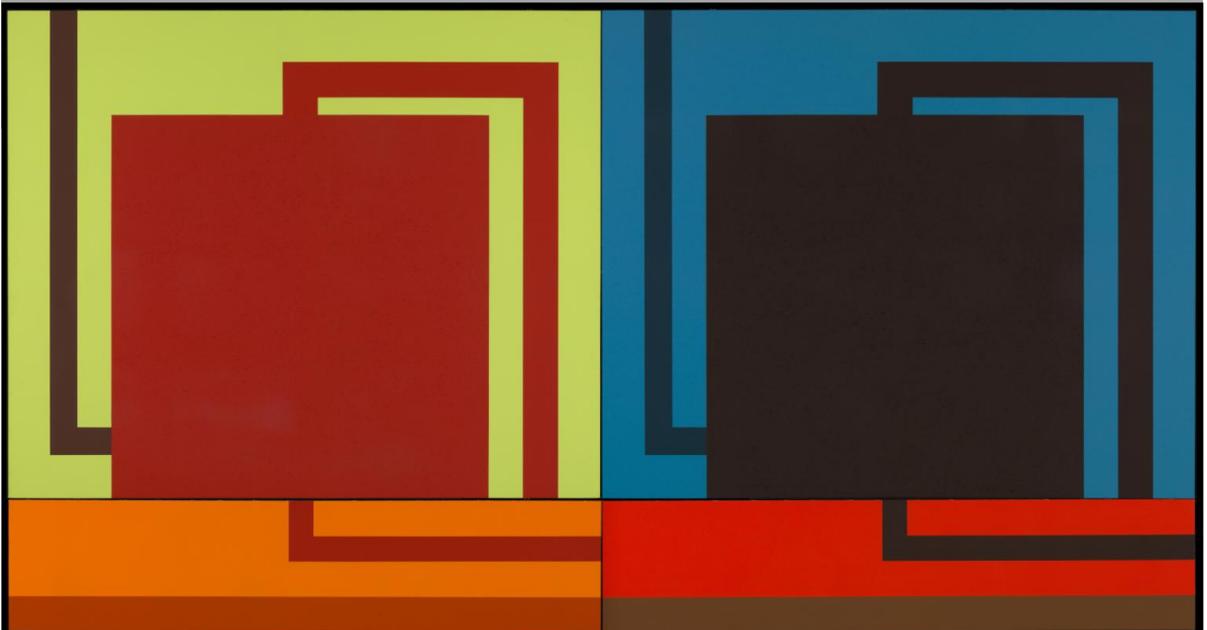
The fund size is expected to be around \$50 million based on a maximum number of 499 accredited investors and a minimum investment per investor of \$100,000. This would allow the fund to acquire 150 to 200 artworks within a price range of \$100,000 to \$500,000 per artwork. THE AAART FUND subsequently sells these artworks after a certain holding period or whenever a great sale opportunity is identified. The fund’s objective thereby is to deliver annual returns of 5 to 10 percent to its investors.

THE AAART FUND utilizes a traditional hedge fund revenue model, which charges the funds’ investors an annual management fee and a performance fee that kicks in when above-average returns are achieved.

THE AAART FUND is set up in such a way that it appeals to both institutional and private investors. Specific marketing activities are developed to successfully reach out to these two different target groups, ranging from undertaking roadshows to collaboration with private wealth managers.

The success of this business depends on its human capital. THE AAART FUND put together a “dream team” of highly skilled people. Their unique competences range from connoisseurship in American art to superb investor relation skills. These potential employees will be proactively approached with competitive employment conditions in order to get them on board of this new art fund.

THE AAART FUND’s employees will be instructed to do their job with care and to take responsibility in achieving the firm’s goal, which is to deliver above-average annual returns to its investors and to be transparent and credible at all times. THE AAART FUND will thereby prove that investing in contemporary American art through pooled investment offers a competitive and rewarding alternative to investments in financial markets.



Peter Halley, *Rob and Jack*, 1990. © Peter Halley, courtesy Tate.

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SECTION I: INDUSTRY OVERVIEW

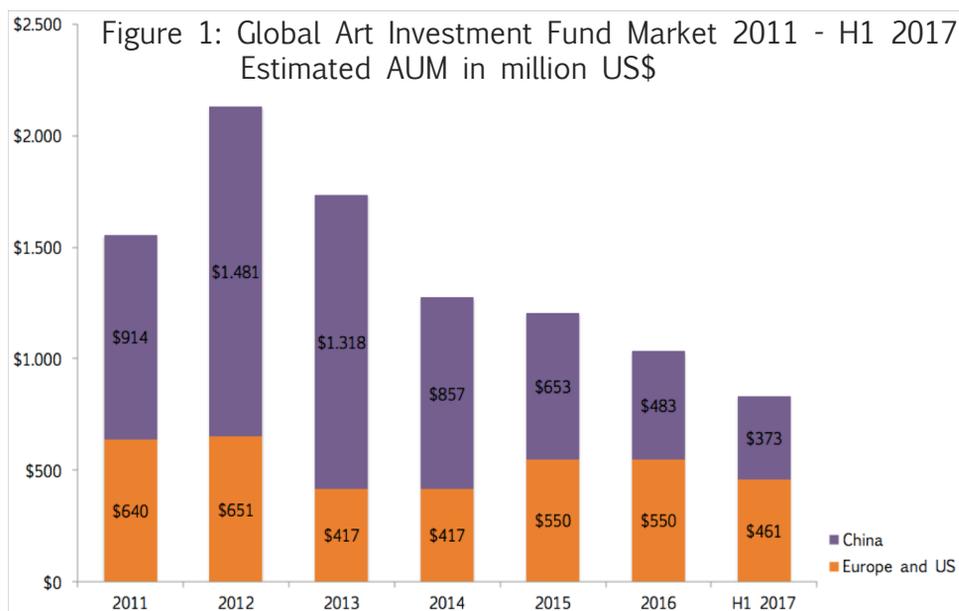
ART FUNDS / EXPLANATION AND ANALYSIS

WHAT IS AN ART FUND?

Art funds are privately offered investment funds dedicated to the generation of returns through the acquisition and disposition of works of art. They are set up as private equity or hedge funds as they aim to securitize the buying and selling of art by giving accredited individuals and institutional investors exposure to the art market through shares in a fund. Most art funds employ a traditional buy and hold-strategy with a long-term investment horizon of 5 to 10 years.

THE ART FUND INDUSTRY / A COMPETITIVE ANALYSIS

Based on the latest Deloitte and ArtTactic - Art & Finance Report, the overall art fund market in the first half of 2017 was conservatively estimated to be worth \$834 million (ref. Figure 1.). This number is accompanied by the note that the actual size of the art investment fund market is likely to be larger than the publicly available data suggest. There simply is no clear overview of how many art funds have been established and operated over the years. The most in-depth but meanwhile somewhat outdated research in this regard is the Art Funds Survey 2015. According to this survey, there were an estimated 72 art funds in operation in June 2014. Of the 72 funds it identified, some 55 were Chinese art funds. The dominance of Chinese art funds is visualized in Figure 1. Remarkably though, it is said that the decrease in the overall assets under management (AUM) in the art fund market over the last five years (ref. Figure 1) is due in large to the Chinese art fund and art trust business winding down, which indicates that the Chinese dominance is waning. An important aspect in this regard is the inherent nature of the art fund industry, which is characterized by high barriers of entry. Setting up an art investment fund is fairly complex and involves high costs, which withholds competition to enter the art fund market.



Source: Deloitte and ArtTactic - Art & Finance Report 2017

While researching the market for art funds, it was noticed that (although many art funds operate from U.S. offices) there is only one art investment firm specialized in American art, called The Collectors Fund. This firm, located in Kansas City, runs two funds: the American Masters Collection I and Twentieth Century Master Collection.

The fact that only two funds specialized in American art are currently in existence, provided a business opportunity, which led to the proposal of THE AAART FUND. In order to ensure that the idea behind the proposed art fund is viable and different from the existing two art funds, a more in-depth competitive analysis followed which is summarized below:

The first fund, the American Masters Collection I, was launched in 2007 and deals in 20th century American art pieces costing less than \$500,000. It was expected to be liquidated around 2017 but whether this happened cannot be confirmed. The second fund, Twentieth Century Masters Collection was launched in 2011 and has a holding period of 8-10 years. This fund invests in 20th-century American art in a somewhat higher price range, as acquired works will be priced between \$500,000 and \$1.5 million. Most remarkable is the community approach employed by both funds in terms of sourcing artworks and servicing investors. For instance, the investors, whom primarily are from the Kansas-City area, enjoy various complimentary services such as art education, networking and social perks. Investors are even offered to bring the investable assets of the funds (i.e. the artworks) into their homes through the Art Rotation Program. On top of that, the founder of The Collectors Fund, Alexander Kemper, was the single largest investor in the first fund, which suggests that the fund was more a personal investment vehicle.

THE AAART FUND will not resemble the two funds described above in any way, except for the investment category which is contemporary American art. More details about THE AAART FUND and how it will differentiate itself from the industry will be described in the next sections. But before delving into the characteristics of the fund itself, it is important to define what contemporary American art is and why this investment category provides such an interesting business case.

AMERICAN ART / ANALYSIS AND PERFORMANCE

WHAT IS CONTEMPORARY AMERICAN ART?

There are many different definitions about this ostensibly simple category. The crux of this definition is in the word *contemporary*. What does this word mean? Generally it is described as the “the art of today, produced by artists who are living in the 21st century” but interpretations of the word *today* may vary widely.

For THE AAART FUND, the definition of today is stretched a bit to be able to include artworks from various decades, which is important for reducing the fund’s overall risk profile. “Contemporary American art” as an investment category for this art fund is therefore defined as: art created by American artists, beginning from the post-war period in the 20th century up until living artists of the 21st century.

WHAT IS AFRICAN AMERICAN ART? / A NICHE

African American art represents a wide range of African American artists whose work reflect the Black aesthetic and the essence of African art. African-American artists are thereby defined as individuals of African or Afro-Caribbean descent who were born in, raised in, or currently residing in the United States.

The reason for including a separate definition of African American art as part of the broader contemporary American art-umbrella is the importance of this art category in the investment strategy of THE AAART FUND. In fact, THE AAART FUND deliberately adds a niche to its region-specific strategy to benefit from the recently discovered potential of African American art as well as to differentiate THE AAART FUND’s investment strategy from other existing art funds. Thus, in addition to the overall contemporary American art strategy, THE AAART FUND will also allocate a portion of the portfolio to African American art.



Glenn Ligon, *Double America 2*, 2014. © Glenn Ligon, courtesy of The Broad.

AMERICAN ART PERFORMANCE / A MARKET ANALYSIS

CONTEMPORARY AMERICAN ART PERFORMANCE

Before delving into a performance analysis of contemporary American art it is important to emphasize why THE AAART FUND chose to focus particularly on *contemporary* art. The reason being, that works from certain art movements prove more profitable than others due to a number of factors incl. trends, cultural awareness and economic growth and prosperity. According to a renowned art investment scholar named Sergey Skaterschikov, many of the best returns in art investments in recent years were earned on contemporary art, and more specifically on works by living artists. There is quantifiable data to support this view. In fact, based on the last publication of the Mei Moses index in 2015, the post-war and contemporary world category outperformed the S&P 500 –the most important American stock market index– on both a 20- and a 50-year basis. Thus, contemporary art seems most suitable to the perception of art as an investment class.

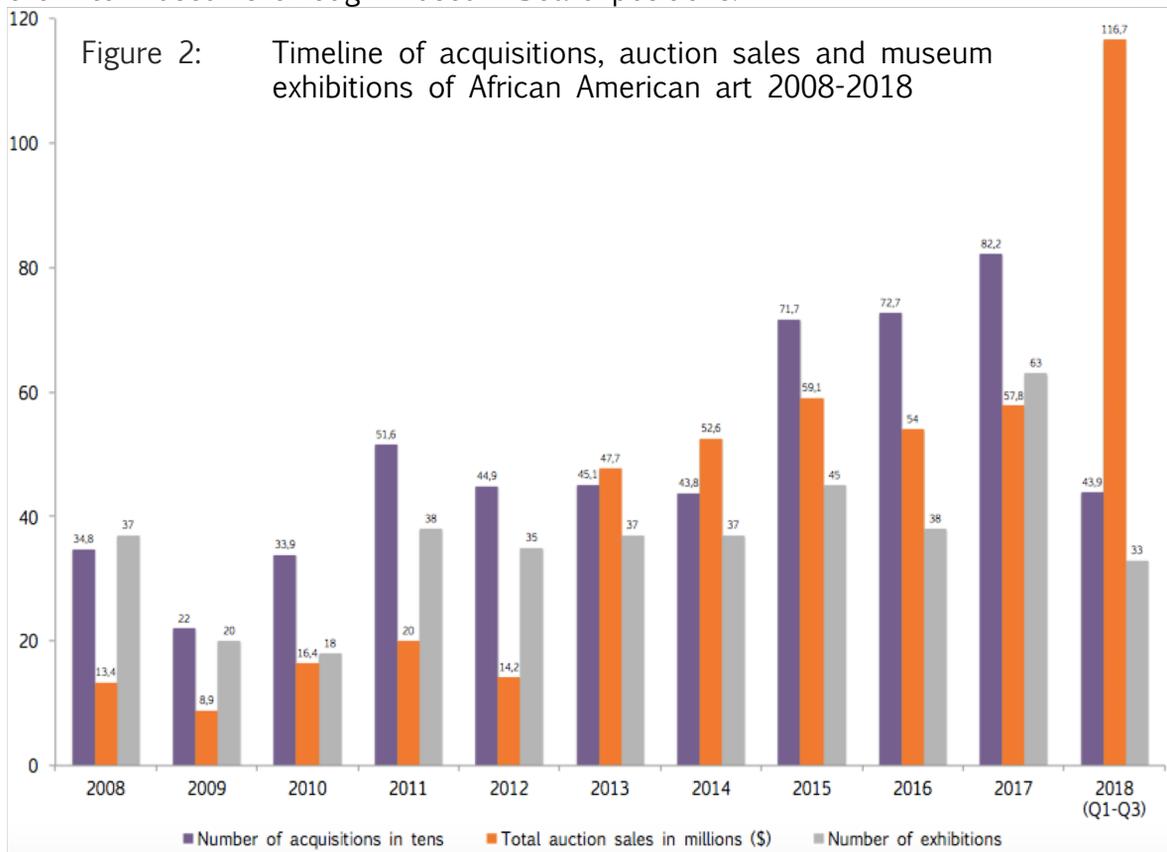
There is a complication though: the art world appears to generalize contemporary art as a global, or actually Western, category. Although there is a tremendous amount of research done on the (post-war and) contemporary art movement, these examinations do not seem to make any geographical distinctions. As a result, it is impossible to come up with specific research on the category under discussion in this proposal, namely contemporary *American* art. The best alternative is to investigate the Western part of the contemporary art market, as Europe and the United States apparently comprise the majority of the market. Artprice even specifically mentions that the post-war and contemporary art periods are mainly dominated by American artists. For instance, Jean-Michel Basquiat and Andy Warhol were still at the top of the segment ranking in 2017 with 3rd and 4th places in the global Top 500.

Artprice's 2017 art market overview shows that the post-war and contemporary art segment is the second largest most lucrative period –after modern art– accounting for 36% of the Western art market's total turnover (\$3.5 billion). The accompanying forecast said that this segment will continue to grow and will eventually outperform the modern art segment. A more recently published overview by Artprice (H1 2018 – Global Art Market Report) shows that post-war art and contemporary art are currently the two segments that show the strongest price increases over the short, medium and longer terms. These two periods of creation enjoy exponential demand which the supply is able to follow. In terms of actual numbers, Artprice's overall index for contemporary art shows a remarkable progression of +27% for the first half of 2018. A long-term investment study even shows that works created by contemporary artists and sold during 2016/2017 yielded an annual return of +7.6% over an 8-year holding period. For works acquired above the \$50,000 threshold, the average annual return is +8.7% on a 7-year holding period. Based on these outcomes, it can be concluded that investments in contemporary art represent a competitive alternative to financial markets.

CONTEMPORARY AFRICAN AMERICAN ART PERFORMANCE

Contemporary African American art –a niche within the broader contemporary American art spectrum– has finally become recognized in the art world and is clearly on the rise. Respected art galleries in both Europe and the U.S. currently represent African American artists. They are also featured in major international museum shows and auction sales are heading into the seven figures. More specifically, 6 out of the top 10 contemporary works sold at auction so far in 2018 are by African American artists according to the Artnet Intelligence Report 2018 (publication date: October 1st). This marks the first year ever that African American artists other than the superstar, Jean-Michel Basquiat, have cracked the top, which indicates the increasing diversity of this genre. Not only Basquiat but also Kerry James Marshall and Mark Bradford are listed in the top 10.

This growing interest in contemporary African American art is in significant part a result of the legacy of the Obama administration. For instance, the Obama’s choice to engage African American artists to paint their portraits for the National Gallery was groundbreaking. Another important driver for this genre is the growth in ultra high net worth African American individuals, who are spending their fortunes on either collecting African American artworks or providing platforms for African American artists such as building residencies and introducing them to museums through museum board positions.

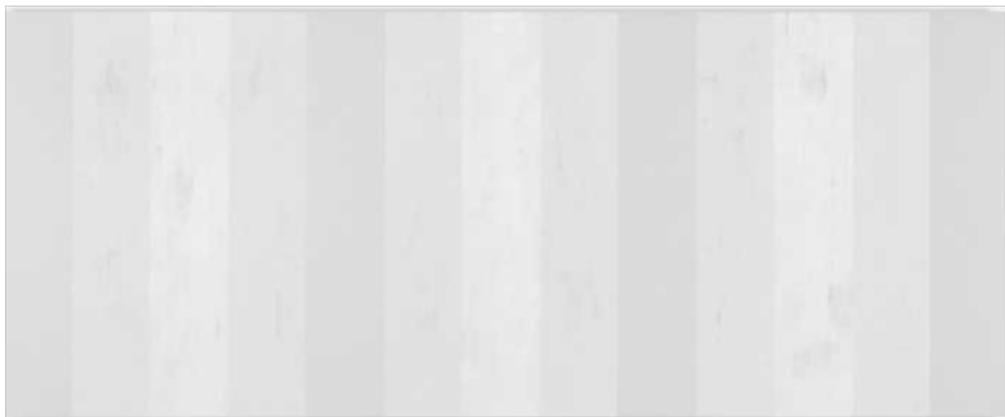


Source: Artnet & In Other Words – Representation of African American Artists in Museums and the Market

Contrary to the broader category of contemporary American art, which lacks a specified research area, the niche of contemporary African art has been thoroughly investigated and quantified over the last months. An important study in this regard is visualized in Figure 2, which shows a timeline of acquisitions, auction sales and museum exhibitions of African American art over a ten-year period (data until October 1st, 2018). These numbers clearly confirm the trends mentioned on the previous page. The total of auction sales is at an enormous peak with \$116.7 million achieved in the first nine months of 2018. Comparing this number with the previous year shows that the total of auction sales nearly doubled in less than a year.

It should be noted however that the top of the African American art market has been consolidating around just five artists: Mark Bradford, Glenn Ligon, Kerry James Marshall, Julie Mehretu, and David Hammons, all of whose combined auction sales over the past decade account for \$297 million –or 64 percent– of the \$460.8 million total spend. The fact that these five individuals currently eat most of the cake does not have to be negative after all. It is more important that the African American art genre is now finally receiving the attention it should have had for decades already. A bright and more diverse future is ahead, as these five top stars paved the way for younger, emerging artists who are currently entering the market. Emerging African American artists will aim for the moon as they feel empowered by the achievements of the top stars and the resulting development of the art market. It is exactly this pool of emerging artists that is of most interest to art investment firms such as THE AAART FUND. The key to success for art funds is to identify the potential of artists early in their careers or at least before other investors or collectors do so. Therefore, it is essential to discover and follow the emerging artists before they will become the new top stars.

In conclusion, the recently increased interest in and growth of contemporary African American art makes it the perfect time to start an investment fund that is partly focused on exploiting the growth potential of this specific genre.



Mary Corse, *Untitled (Multiband with White Sides, Beveled)*, 2018. © Mary Corse, courtesy Lisson Gallery.

SECTION II: THE AAART FUND

THE FUND AND THE FIRM / NAME AND STRUCTURE

INTRODUCTION OF THE AAART FUND

The market analysis in the previous section already gave away what kind of art THE AAART FUND will be investing in. However, it has not yet been mentioned that the fund's region specific investment strategy can also be derived from the name of the fund itself. The three A's in THE AAART FUND serve as an acronym for (African) American Art, which points to the proposition that the fund will only include artworks from American artists and will devote a special percentage of the portfolio to African American art. In addition, the three A's symbolize a triple A-rating in the financial industry, that is a rating used to identify bonds with the highest credit quality. In this case it does not refer to the creditworthiness of bonds but it rather is a creative twist to emphasize that THE AAART FUND will only select the highest quality of art available in the market. Thus, two important features of this new art fund –focus on *quality* and (*African*) *American art*– can be derived from its name. More detailed information about the fund's characteristics will follow after an explanation of the legal structure of THE AAART FUND and the company behind THE AAART FUND is provided.



Robert Longo, *Untitled (The Pequod)*, 2014. © Robert Longo, courtesy of mueinck.com.

LEGAL STRUCTURE OF THE AAART FUND

Art funds generally adhere to the traditional hedge fund structure of a limited partnership. The most common form is a limited liability company (LLC), which consists of a managing general partner(s) and a limited partner(s) who invest in the fund. The general partners are the entrepreneurs who are active in the day-to-day operations of the business. The limited partners –also known as silent partners– are the investors in the fund, whose liabilities are limited to the amount of their investment in the company. An important note in this regard is that although the word “partner” gives the impression that it concerns an individual, partners in an LLC are usually business entities rather than individuals.

THE AAART FUND (i.e. the fund itself) will also be part of a limited partnership structure. The company behind the fund, called THE AAART FUND LLC, will be registered in the U.S. (and thereby abiding to U.S. law). THE AAART FUND LLC will be the general partner, whereas the investors in the fund (i.e. the clients) will be the limited partners. The general partner will be responsible for running the business and is thereby tasked to provide the financial and investment expertise to THE AAART FUND.

In terms of registration of the art fund itself and the fund’s equity interests, THE AAART FUND is set up in such a way that registration of the fund itself and registration of the fund’s equity interest can be avoided. The requirements for avoiding these registrations are described below.

- **Avoidance of registration of THE AAART FUND itself:** The 40 Act requires that investment companies register as such with the U.S. Securities Exchange Commission (“the SEC”) and comply with the burdensome set of rules relating thereto. To avoid being characterized as an investment company, THE AAART FUND must comply with two established exceptions, namely have less than 100 investors in the art fund or up to 499 investors that are all “qualified” investors. Referring to the Marketing Plan (Section IV, p. 25-26), where the target audience of THE AAART FUND is defined, THE AAART FUND will limit its investor pool to a maximum of 499 *accredited* investors. THE AAART FUND, therefore, will not have to be registered as an investment company with the SEC.
- **Avoidance of registration of THE AAART FUND’s equity interest:** In order to avoid registering THE AAART FUND’s securities with the SEC as an initial public offering pursuant to the Securities Act of 1933, THE AAART FUND must offer their securities privately pursuant to a Reg. D private placement. To satisfy the private placement exemption, THE AAART FUND will limit its offering to accredited investors, make full and fair disclosure of all material elements of the investment in the art fund by way of a private placement memorandum and subscription agreements and file a notice with the SEC and “blue sky” notices with New York state securities regulators that sales of THE AAART FUND’s equity interest are being made in reliance on Reg. D.

THE AAART FUND / FUND INFORMATION

FUND FACTSHEET / AN OVERVIEW OF THE FUNDS' CHARACTERISTICS

Fund name	THE AAART FUND
Investment firm	THE AAART FUND LLC (registered in the U.S.)
Investment strategy	Region-specific investments in art
Investment objective	Long-term capital appreciation through a diversified art portfolio
Art category	Contemporary (African) American art
Fund manager	<i>To be confirmed</i>
Fund size / AUM	Approx. \$50 million
Number of assets	150 - 200 artworks
Average asset price	\$100.000 - \$500.000
Number of investors	Maximum 499 investors
Minimum investment	\$100.000
Holding period	Ten year lock-in period (buy- and hold strategy)
Performance goal / return	5-10% per annum net of fees
Fee structure	Annual 2% management fee and 20% performance fee (hurdle: 7%)



Mark Bradford, *Sea Pigs*, 2014. © Mark Bradford, courtesy of Gemeentemuseum.

INVESTMENT STRATEGY

THE AAART FUND seeks to acquire works of art, which in the view of the fund manager, will have a higher valuation in the marketplace, either immediately or in the future. Artworks will be selected based upon the fund's region-specific investment strategy, which focuses on contemporary American art only, that is, art created by American artists, beginning from the post-war period in the 20th century up until living artists of the 21st century. THE AAART FUND is specialized in a specific niche within the broader investment strategy, namely contemporary African American art. A specific portion of the portfolio will therefore be allocated to contemporary African American art.

Diversification is key in the selection of artworks, as it serves to mitigate risk. In order to ensure a diversified portfolio, THE AAART FUND's investment strategy consists of a 65% *value*- and 35% *growth* style. This means that approx. 65% of the assets will consist of artworks by more established American artists from whom it can reasonably be expected that their value will increase over time, and approx. 35% of the assets will relate to more "risky" investments in artworks by more emerging artists. Contemporary artworks by African American artists, for instance, are accounted for in the riskier section of the investment portfolio. African American art is a fairly new category in investment terms and therefore has a higher risk profile. The percentage distribution of these investment styles is at the discretion of the fund manager. Adjustments can be made during the investment process according to changing market trends.

Diversification is not only achieved through utilizing varied investment styles, but also by aiming for a relatively large fund size. The expected assets under management of THE AAART FUND is expected to be around \$50 million, which is derived from the following two numbers:

- A minimum investment per investor of \$100.000
- A maximum number of investors of 499

Investors of course have the option to invest more than \$100.000 but this number serves as an indicator of the fund size.

A large fund size is beneficial in terms of diversification as it enables THE AAART FUND to acquire more assets which will reduce the risk of the overall portfolio. THE AAART FUND aims to acquire 150 to 200 artworks, within a price range of \$100.000 to \$500.000 per artwork. Combining the respective averages of these numbers –that is 175 artworks at an average price of \$300.000– confirms that the fund size will lie at around \$52,5 million. This budget is obviously dependent on the inflow of investments. Moreover, the fund will never be fully invested at all times. A cash reserve for the purpose of risk management will be held. The minimum cash reserve is set at 2.5% of the portfolio value.

INVESTMENT CYCLE

THE AAART FUND employs a traditional buy- and hold strategy with a long-term investment horizon of 10 years. It is a closed-end investment vehicle meaning that investors are only able to purchase shares until a certain point in time at which the fund is “closed”. The invested capital is at that moment “locked up” in the fund and shareholders can redeem their equity only at pre-allocated intervals or at the end of the fund’s term as it is drawn down. The effective closing date of THE AAART FUND is decided upon at a later stage, as this decision depends on the market interest.

Once the capital is raised, or at least enough money is secured to begin investing on an initial tranche of capital before the fund is closed, the fund starts to purchase artworks. Most investments (i.e. acquisitions of artworks) of THE AAART FUND will take place in years 1 to 4, while divestments (i.e. de-accessioning of artworks) will occur in years 3 to 10. After a certain mandated point –generally around year 3 or 4, THE AAART FUND will no longer make purchases but will hold inventory until an optimal sales opportunity is identified. Both private sales and auction sales could be possibilities for the liquidation of THE AAART FUND’s assets. Transacting through auction houses is less preferred though, because of the hefty sales commissions and buyer’s premium expenses. The implementation of the investment and exit strategy is at the discretion of the fund manager, as adjustments might be imperative as a result of changing market trends.

INVESTMENT OBJECTIVES

The goal of THE AAART FUND is long-term capital appreciation through optimized exposure to contemporary (African) American art. THE AAART FUND aims to deliver returns between 5 and 10 percent per annum net of fees. This promise is obviously dependent on market expectations and can therefore possibly be adapted to the fund manager’s outlook.

INVESTMENT TERMS AND REQUIREMENTS

Investors interested in investing in THE AAART FUND must be aware of the following investment terms and requirements. First of all –as mentioned above, investors should be willing to commit to the fund’s lock-in period of 10 years. Secondly, the minimum investment for THE AAART FUND is set at \$100.000 per investor. Thirdly, investors should be aware of the “2 and 20”-fee structure, which entails (i) an annual management fee of 2% of the net asset value of the fund’s art portfolio and (ii) a 20% performance fee on earnings above the hurdle of 7%. The performance fee is also known as an incentive fee, as it aims to tie a fund manager’s compensation to their level of performance. The performance fee thus serves to align the interests of the fund manager with those of the fund’s investors. With respect to the requirements for the investors themselves, THE AAART FUND only accepts *accredited* investors. This term and its prerequisites are extensively addressed in the Marketing Plan (Section IV: p. 24-31).

EXECUTION OF THE INVESTMENT STRATEGY

THE AAART FUND has a curatorial mandate that drives the selection and allocation of individual artworks. This mandate is backed by a structured and research-based investment process, which is both top-down and bottom-up and is informed by both quantitative and qualitative analyses. THE AAART FUND follows an eight step approach in executing its investment strategy:

1

Determination of the overall allocation

Macro-economic analyses to determine the overall allocation, i.e. an assessment of art market conditions, global economic conditions, the availability of attractive investment opportunities, and suitability of investments to the risk/return profile of the investment strategy.

2

Assessment of liquidity and cash deployment

A decision on how to deploy the pooled capital for investment:
- using available cash from committed capital, or
- liquidating another investment?

3

Employment of investment analysis expertise

A curatorial review of the contemporary (African) American art landscape to determine how trends in these categories would influence the future performance and risk management benefits of the fund.

4

Identification and sourcing of potential opportunities

The fund manager exploits his art expertise and network to search for potential investments that meet the fund's criteria.

5

Due diligence and negotiation

Background and condition checks are executed to determine the quality of a particular artwork. Negotiation of the transaction price will also start at this point in time to determine the potential profitability of the potential investment.

6

Determination of the portfolio suitability

The fund manager investigates the unique fit of a potential investment with the existing portfolio. In case the cash balance allows the acquisition, the investment will be submitted for approval.

7

Execution of transactions

Approval of a proposed acquisition (based upon the contractual terms on an invoice, bill of sale, commitment letter, or other type of transaction contract) means that the transaction can be executed.

8

Continuous reassessment of cash and exposure

Ongoing review of the new composition and asset allocation of the investment portfolio. The cash balance of the fund is carefully monitored and potential divestment opportunities of the new asset are considered.

POTENTIAL FUND ASSETS / EXAMPLES OF ARTWORKS

The following artworks serve as examples for potential acquisitions by THE AAART FUND. The accompanying descriptions explain why these particular artists might be potential candidates for investment. To give a realistic picture, only artworks were included that were recently available in the art market (i.e. October, 2018). Please note that the various artworks that have been featured throughout this document also serve as examples of artists that are considered “investable”.

CONTEMPORARY AMERICAN ARTWORKS



Diana Al-Hadid, *Interior Sketch*, 2014

Polymer modified gypsum, fiberglass, stainless steel, pigment (3 separate panels)
78¾ x 106¾ x 1¾ in; 200 x 245 x 4 cm
\$120,000 at Marianne Boesky Gallery (U.S.)

The talented Diana Al-Hadid has only lately received recognition in the art world. Her recent solo-show at the Bronx Museum promises a golden future, both in terms of artistic production and monetary value.



KAWS, *Untitled*, 2011

Acrylic on canvas
20 in; 50.8 cm (diameter)
\$200,000 at I.D.E.A. (U.S.)

KAWS, a graffiti-artist and designer, knows how to bring arts and commerce together. He is incredibly popular amongst collectors. For instance, KAWS' top 10 auction records have all been achieved in 2018, with almost all exceeding the high estimate.



Jenny Holzer, *Selection from Truisms: Raise boys and girls ...* 2015 - (Edit. 1/6)

Cippollino Crema Tirreno marble footstool
17 x 25 x 16 in; 43.2 x 63.5 x 40.6 cm
\$150,000 at Sprüth Magers (Germany)

Jenny Holzer began her successful *Truism*-series in the 70's, but this powerful series has been constantly reinvented due to consistent market interest. Her current solo-show at the Tate Modern provides good “momentum” for this lasting art star.

CONTEMPORARY AFRICAN AMERICAN ARTWORKS

Julie Mehretu, *Not Quite Armageddon*, 1997

Ink and acrylic on canvas
24 x 36 in; 61 x 91.4 cm
\$185,000 at McClain Gallery (U.S.A)

Julie Mehretu's features in Artprice's Top Female Artists 2017/2018 and The African Top Art 10 spearheaded the market interest in both her paintings and drawings. At auction, she is moving up from the \$100,000 - \$500,000 range towards \$1 - \$5 million hammer prices.



Kehinde Wiley, *Portrait of Quentin Lee Moore*, 2018

Oil on wood panel
59 4/5 x 48 in; 152 x 122 cm
\$200,000 at Templon (France)

Kehinde Wiley's portraiture of young black men became iconic after he was commissioned to paint President Obama's portraiture for the Smithsonian National Portrait Gallery in 2017. Wiley's turnover is continuously on the rise, as his works are highly sought-after on both the primary and the secondary market.



Martin Puryear, *Face Down*, 2008

Bronze
15 x 28 x 11 in; 38.1 x 71.1 x 27.9 cm
\$375,000 at Berggruen Gallery (U.S.)

The art market for Martin Puryear, who had retrospective exhibitions at both MoMA and the Smithsonian American Art Museum, has developed steadily over his career. Puryear will represent the U.S. in the 2019 Venice Biennial, which will supposedly boost the market interest in his abstract sculptures.



SECTION III: OPERATIONS PLAN

THE FIRM / LOCATION

THE OFFICE

THE AAART FUND LLC will be located in a shared office building in Midtown in New York City). Midtown is centrally located in Manhattan and easily accessible with (public) transportation. An office in this area has the advantage of being close to potential investors (e.g. institutional investor-firms in Midtown and wealthy individuals typically living in the Upper East Side) and external parties providing consultation (e.g. legal, accounting and tax support). The office needs to provide desk-room for at least 5 full-time employees, based on the initial staffing that is presented on pages 21-23. The office also requires a decent reception, small kitchen and private meeting room. The meeting room will be used for both internal meetings as well as meetings with potential investors. The office should have a luxurious appearance, as this will assist in building a prestigious reputation for the firm.

Since the exact launch date of THE AAART FUND LLC is not yet known, it does not make sense to commit to a rental contract at this point in time. The exact location of the firm will therefore be communicated later. But an example of an office space that meets the requirements mentioned above is presented on the next page.

THE WAREHOUSE

In addition to the office, THE AAART FUND LLC also needs a place for storage of the fund's assets, that is, the artworks. Rather than storing the art inventory in a warehouse nearby Manhattan, THE AAART FUND's assets will be stored in a "freeport" in Delaware. There are three major reasons for doing this, all of which are aimed at reducing the cost of storage. First of all, Delaware is one of only five states in the U.S. without a statewide sales or use tax. This means that if art purchases are directly shipped to Delaware, sales/use tax can be avoided for as long as the physical items remain in Delaware. Secondly, the Delaware Freeport art storage facility is certified as a "foreign-trade zone". Such a zone is defined as a geographical area, in (or adjacent to) a U.S. Port of Entry, where commercial merchandise (both domestic and foreign) receives the same Customs treatment it would have if it were outside the commerce of the U.S. Thus, in case THE AAART FUND acquires artworks internationally, it is exempt from paying import taxes or duties, which can be 5 to 15 percent of an artwork's value. Thirdly, Delaware art storage facilities generally charge customers 20 percent less than equivalent facilities in New York.

The choice for THE AAART FUND's warehouse is not only based on cost benefits though. Most importantly, the Delaware Freeport is known for providing art storage with the highest level of quality and security. More detailed information about this warehouse and its services is presented on page 20.

EXAMPLE OFFICE ON LEXINGTON AVENUE AND EAST 42ND STREET



SHORT DESCRIPTION:

- A historical Art Deco building with direct access to Grand Central Terminal;
- A modern fully furnished office with team rooms, spacious conference rooms, two copy-centers, a stocked kitchen and pantry area;
- 24-hour access/security and availability of a professional reception service;
- The amenities include Wi-Fi and high-speed internet, telecom (incl. telephone answering), and optionally IT and administrative support;
- Both short- and long-term leases are available for a 5-person office;



Please note that in addition to the amenities that are included in such a lease, THE AAART FUND LLC will need to acquire other office equipment and supplies, ranging from computers to software packages and R&D subscriptions.



DELAWARE FREEPORT / WAREHOUSE



SHORT DESCRIPTION:

- Located in Newark (DE), just 2 hours from New York City;
- 36,000 square feet of art storage with the most advanced art security systems and discrete data security;
- Museum-grade temperature and humidity controlled storage;
- A viewing room featuring plywood-reinforced walls for secure hanging and viewing;
- Secure administration and management of inventory by the local storage registrar;
- Crating, (un)packing and handling services are available;
- Full customs and import services are available (e.g. import clearance, bonding and insurance);
- Transport services to New York City (e.g. special deliveries with air ride, climate controlled trucks and trailers) are available;
- Free shuttle service to the local Amtrak train station and airport.

THE ORGANIZATION / STAFFING

THE (DREAM) TEAM

Since this is a business “plan” about a company that still has to be founded, not every aspect of the business has been fully developed or confirmed yet. The composition of the team behind THE AAART FUND is one of the things that is a “work in progress”. This means that the recruitment process of employees is on-going. Given that the success of this business depends on its human capital, the recruitment and selection process has the highest priority. Job openings are widely shared and candidates are actively approached. For some special cases, hiring a head-hunter might be considered as well.

As a result of these on-going developments, this section presents a “dream team” –rather than an actual team page. That is, certain candidates that seem perfectly suited for a specific job are suggested as potential employees of THE AAART FUND. These suggestions are based on extensive research, whereby the individual is matched with the job’s requirements. Since some jobs require more specific knowledge or experience over others, not all positions are matched with a “dream employee”. For instance, the office manager will be sourced through an open recruitment platform such as glassdoor.com. Therefore, this position does not have a specific candidate attached to it yet. An overview of THE AAART FUND’s team / job positions (incl. a job description) is presented on the next two pages.



Kara Walker, *Exodus of Confederates from Atlanta*, 2005.
© Kara Walker, courtesy of MoMA.

JOB DESCRIPTION:		IDEAL CANDIDATE:
<p>DIRECTOR / FOUNDER</p> <ul style="list-style-type: none"> - Finance executive of the firm (e.g. raising start-up capital for the firm); - Management of the overall operations of the firm, fund and team; - Liaising with creditors and other external parties; - Building a network and reputation for the firm/fund; - Assisting the IR-manager in sourcing investors. 		<p>JILL JONGEN</p> <p>Holding 2 Masters (an MBA and a degree in Art Business), Jill acquired the knowledge and skills to run an art firm. She also worked as a private banker at BNP Paribas for 2 years. Jill knows how to manage investments and clients. Overseeing of operations, finance and relations is what she is best at, which will make her succeed as a director.</p>
<p>FUND MANAGER</p> <ul style="list-style-type: none"> - Curator/strategist of the fund; - Specialist in American art; - Researching and monitoring the art market and the specific art categories; - Implementation of the investment strategy, i.e. identifying and acquiring artworks and managing/timing divestments of the fund; - Liaising with art dealers; - Close collaboration with the IR- and portfolio manager. 		<p>WILLIAM HAYDOCK</p> <p>William has 8 years of work experience as an American art specialist (first at Sotheby's, later at Christie's). Prior to that, he spent roughly 3 years working in finance and private wealth management at UBS. Because of William's extensive experience in both the art and financial industry, he seems the perfect candidate for fund manager of THE AAART FUND.</p>
<p>PORTFOLIO MANAGER</p> <ul style="list-style-type: none"> - Portfolio- and asset management (e.g. monitoring fund allocation and net asset value calculations); - Financial controlling and risk management of the fund; - Quantitative analytics and reporting (e.g. creating fund performance reports); - Handling administrative compliance matters; - Close collaboration with the fund manager. 		<p>ALESSANDRO FIOROTTO</p> <p>Alessandro worked in various finance positions, ranging from M&A-analyst at Citigroup and PwC to portfolio manager at 23 Capital. Currently he is Vice President at The Fine Art Group and responsible for the company's art funds. His extensive experience with managing various investment portfolios makes him highly sought after as portfolio manager for THE AAART FUND.</p>

JOB DESCRIPTION:

IDEAL CANDIDATE:

INVESTOR RELATIONS MANAGER

- “Fund-raising” or sales, i.e. actively seeking investors;
- Communication/reporting to investors (e.g. roadshows, research and presentations);
- Public representative of the firm/fund (i.e. PR matters);
- Marketing of the firm/fund;
- Ensuring compliance on regulatory matters;
- Close collaboration with the fund manager.



PENELOPE DU JEU

With a strong interest in arts (a B.A. in Art History and work experience at art galleries and Christie’s) and demonstrable communication skills, Penelope is competent in attracting investors for THE AAART FUND. She knows what it takes to manage investor relations, as she has been working as an IR-manager at Lendable in London for about 3 years now.

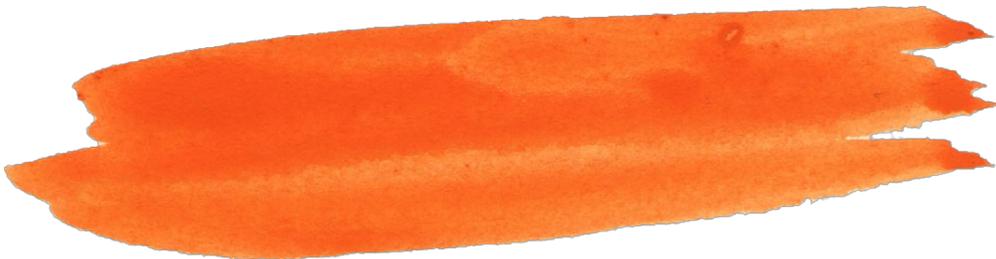
OFFICE MANAGER

- Representation of the firm (i.e. guest reception);
- Office operations (e.g. scheduling meetings and controlling correspondence);
- Management of office supplies and equipment;
- Administration and filing;
- Preparation of the payrolls;
- Assisting the fund manager in the transportation/storage of the fund’s assets.



TO BE ANNOUNCED

This position will be filled in based on an open call that will be shared on a public recruitment platform (online). No individual recruitment will be undertaken, that is, there is no specific “ideal” candidate for this position.



SECTION IV: MARKETING PLAN

MARKETING THE FUND / TARGETING THE AUDIENCE

INVESTORS / LEGAL REQUIREMENTS

In order to qualify to invest in U.S. art funds, investors must be considered “**accredited investors**” under the Securities and Exchange Commissions (SEC) guidelines, meaning that they are financially sophisticated individuals or institutions that require less protection than their unsophisticated counterparts. For an individual to qualify for this accredited investor status, they must meet one of the following three criteria:

- 1) Have a net worth exceeding \$1 million, either individually or jointly with a spouse (excluding the value of their personal residence);
- 2) Have an individual income in excess of \$200,000 per year during the past two years; or
- 3) Have a joint income of \$300,000 during each of the last two years and reasonably expect the same level of income moving forward.

In addition to this, there are also some important legal restrictions in terms of the number of investors in an U.S. art fund. First of all, art funds may permit up to 35 investors to be non-accredited; however to do so requires more significant financial disclosures and presents additional challenges with respect to compliance. Secondly, U.S. art funds should fall within one of two exceptions of the Investment Company Act of 1940 (the “40 Act”) in order to avoid the need to register as an “investment company” under such act:

- Section 3(c)(1) of the 40 Act provides that an art fund can avoid registering if its equity interests are sold privately to no more than 100 investors.
- Section 3(c)(7) of the 40 Act provides that an art fund is not subject to regulation under the 40 Act if the total investors in such fund are less than 500 and all such investors are “qualified purchasers”, defined generally as natural persons with at least \$5 million in investments, institutional investors with \$25 million or more in investments and certain knowledgeable employees of the art fund or its advisor.

Based on the legal requirements mentioned above, THE AAART FUND will limit its investor pool to a maximum of 499 *accredited* investors.

TARGET AUDIENCE / PRIVATE AND INSTITUTIONAL INVESTORS

Now that THE AAART FUND investor pool has been defined from a legal perspective, it is time to look into this group from a marketing perspective. Defining the potential group of investors –in marketing terminology known as the “target audience”–, is the key element for any effective marketing strategy. In fact, the marketing strategy is build around the target audience and aimed at convincing the target market to invest in the business. In the broadest sense, the target audience of THE AAART FUND will consist of both *private* investors and *institutional* investors. These different types of investors are described in more detail in the two sub-sections on the next page.

INSTITUTIONAL INVESTORS

An institutional investor is an organization that trades securities in large enough share quantities or dollar amounts that it qualifies for preferential treatment and lower commissions. There are generally six types of institutional investors in the financial industry: pension funds, endowment funds, insurance companies, commercial banks, mutual funds and hedge funds. Although institutional investors have traditionally been hesitant to invest in collectibles such as art, several recent examples have shown that this category can definitely be targeted in sourcing investors. For example, the proportion of institutional investors in The Wine Investment Fund (founded in 2004) is said to be around one-third and constantly rising. This proves that institutional investors are interested in investing in collectibles. THE AAART FUND will therefore reach out to all types of institutional investors mentioned above, except endowment funds. Examples of possible institutions are:

- Pension funds: government pension funds (e.g. Norwegian Government Pension Fund), multi- or single employer pension funds (e.g. Shell Pension Fund), ...
- Insurance companies: AXA, AIG, Allianz, MetLife, ...
- Commercial banks: JPMorgan Chase, Citi, ING, UBS, ...
- Mutual funds: Fidelity, Vanguard, PIMCO, Franklin Templeton, ...
- Hedge funds: BlackRock, Bridgewater Associates, Winton Group, Pictet, ...

PRIVATE INVESTORS

Private investors in THE AAART FUND will have to adhere to the qualifications for accredited investors as mentioned on the previous page. As a result of these legal requirements, THE AAART FUND will specifically target high net worth individuals (HNWI) or ultra high net worth individuals (UHNWI), which are terms used in the financial services industry to denote an individual or family with liquid assets above a certain amount. HNWI are considered to have at least \$1 million in liquid assets, whereas UHNWI typically have more than \$30 million in wealth. Even though this classification might seem to exclude many investors, the global pool of (U)HNWI is immense. For instance, The Capgemini World Wealth Report calculated that the United States had more than 5.28 million HNWI in 2017. As it would be very costly to reach out to such a big pool, it is important to narrow down the private investor-part of THE AAART FUND's target audience. In order for the investment strategy to appeal to the audience, THE AAART FUND will focus on individuals already investing in or collecting art. More specifically, in seeking private investors it will be important to target investors whom are particularly interested in contemporary (African) American art. Extensive and continuous research will be done to identify these individuals. A small summary of a preliminary target market database, classifying potential art collecting investors according to the respective artistic genre, is presented on the next page.

CONTEMPORARY AMERICAN ART COLLECTORS



Alice Walton

Heiress to the fortune of Wal-Mart stores, founder of the Crystal Bridges Museum of American Art and owner of a \$500 million art collection that predominantly consists of legendary contemporary American artists.



Marc and Jane Nathanson

L.A.-based art collectors' and philanthropists' couple, whom have been collecting American (pop) art masterpieces for decades. Jane also sat on the board of directors of LACMA in its first years of development.



Edward J. and Julie Minskoff

Art collectors' couple, who –in addition to their renowned collection of Picasso's– own many pieces by American artists, ranging from Abstract-ists such as Jackson Pollock to contemporaries such as Richard Prince & Jeff Koons.

CONTEMPORARY AFRICAN AMERICAN ART COLLECTORS



Alfred J. Giuffrida and Pamela J. Joyner

Activist art collectors' couple, whose collection is focused on previously under-appreciated African American artists. “The collection is mission-driven and the mission is to rewrite art history.” (Source: Sotheby's interview in 2017)



Tina Knowles Lawson

Fashion-designer and mother of celebrity-singers, Beyoncé and Solange Knowles, known for collecting contemporary African American art for an educational purpose and to support Black artists.



Rodney M. Miller

Managing director of M&A at JPMorgan Chase who collects primarily contemporary African American art in his leisure time. He currently serves on the board of directors of the Studio Museum in Harlem.

STRATEGIC MARKETING / DESCRIPTION OF THE PLAN

MARKETING STRATEGY / OBJECTIVES

The marketing plan of THE AAART FUND, that is presented on the following pages, outlines the strategy and tactics that will be used to “market” the fund towards its target audience. Most important in this regard is the overarching marketing strategy, which aims to build a corporate brand that creates awareness for THE AAART FUND. The ultimate goal thereby is to attract investors and build a strong investor base. In order to successfully reach out to potential investors, specific marketing activities are developed for the two different target groups. But before delving into the proposed marketing activities, attention is devoted to the creation of a corporate brand and identity.

CORPORATE BRANDING / BUILDING THE BRAND

The first step in building a brand is creating a recognizable logo and corporate identity, which will be used in all external communication. The font sizes and colors pertaining to the corporate brand are custom made for THE AAART FUND. Several renderings of THE AAART FUND’s corporate identity are presented below:

Logo



Letterhead



Business cards



Please note that the font sizes, colors, and presentation style that have been used throughout this business plan exemplify the corporate identity of THE AAART FUND. This business plan is basically one big rendering of what the brand will look like. Building a brand as such is essential in creating awareness for the firm.

MARKETING ACTIVITIES / ACTIONS

In order to achieve the objectives outlined in the marketing strategy, quite some work has to be done. Several marketing activities will be undertaken to ensure a strong brand awareness for THE AAART FUND. These activities are divided in three categories: general activities, activities specifically directed at institutional investors and activities specifically directed at private investors.

GENERAL MARKETING ACTIVITIES

This category describes various marketing channels that provide the general public with information about THE AAART FUND. In this day and age, building an online presence for a new venture has top-priority, particularly for firms that operate in the financial industry. The development of a website has therefore the highest priority. www.theaaartfund.com will serve as a communication channel for interested investors, which provides information about the fund (i.e. fund characteristics, investment requirements etc.), the team, and contact details. There will also be a separate log-in section, which will lead existing investors to a page with more confidential information. In addition to the general information provided above, the website will also provide access to two important documents that form the core of the marketing of the fund:

- **The prospectus:** a formal legal document that contains details on the fund's objectives, investment strategies, risks, performance, distribution policy, fees and expenses and fund management.
 - At first a *preliminary prospectus* will be published which is the first offering document provided by THE AAART FUND and includes most of the details of the business and transactions in question.
 - The *final prospectus*, containing finalized background information including such details as the exact number of participations will be printed after the fund has closed for investors.
- **The factsheet:** a basic and easy-to-read document that gives an overview of the fund, which allows even the greenest investor to be aware and up-to-date on the key facts of the fund. These factsheets will be prepared on a quarterly basis.

The prospectus and factsheets are really the most important documents for potential investors, as they contain all relevant information regarding the fund. As financial investments are known to be complex material, it is important to take an educational stance in the promotion of THE AAART FUND. Many people, especially those who are new to investing in art, are not familiar with art funds. Providing extensive and transparent information about THE AAART FUND through such documents as the prospectus and factsheets is therefore essential in selling the fund to even the most skeptical investors. Last but not least, THE AAART FUND will also be present on social media, more specifically on LinkedIn. Having a company page and employee representation on LinkedIn serves two important purposes: 1) a place for promotion and sharing information about the fund/company, 2) a place to source potential investors through the interconnected LinkedIn-network.

MARKETING FOR INSTITUTIONAL INVESTORS

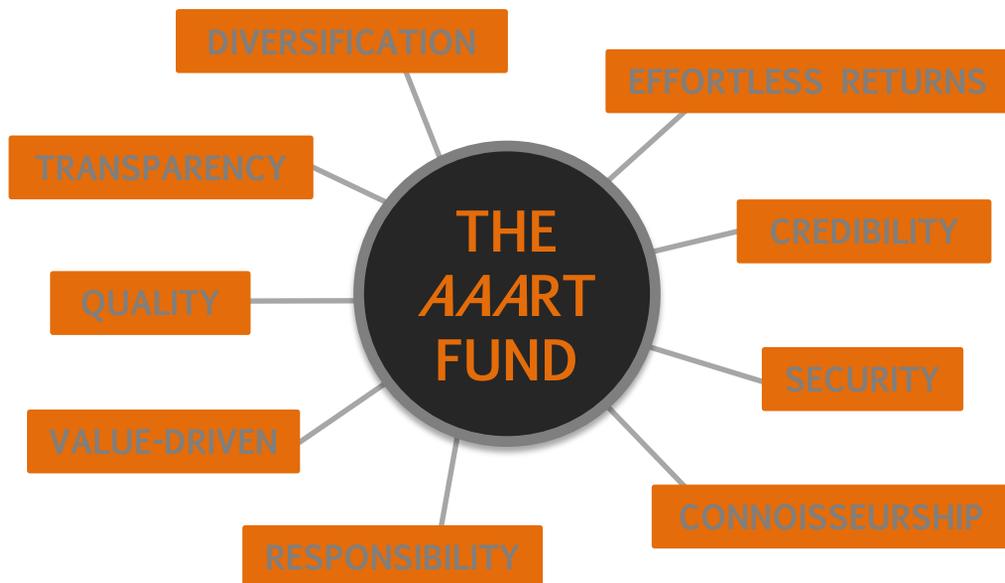
Traditional business-to-business marketing techniques will be used to appeal to institutional investors. Most common in the financial industry, especially for mutual funds, is to organize so-called “road shows” to promote the fund to potential investors. A financial roadshow is a series of meetings across different cities in which the fund manager and the sales manager have the opportunity to present their fund to investors. At first, THE AAART FUND’s road shows will serve to convince potential investors to invest in the fund. Once the investors are on board, the road shows do not cease to exist but they will rather be used to update the investors about the fund’s performance. Another way to actively promote THE AAART FUND to a large pool of institutional investors is to pitch at a conference. An example could be to participate in the annual Art Investment Conference organized by the London Business School. Moreover, paid advertisements are always an option. But since advertising campaigns (e.g. commercials and advertisements in magazines) can be very costly, THE AAART FUND will not engage in advertising in the beginning. Possible alternatives in this regards are arranging interviews with professional magazines or news channels. For instance, a short article in the annual Art & Finance Report presented by Deloitte and ArtTactic could be a great opportunity. Partaking in relevant panel discussions are also cheap options to gain attention. An interview or panel discussion does not happen by itself though. Networking is essential to arrange such free opportunities for promotion. The team behind THE AAART FUND will be instructed to actively network, both for advertising as well as sourcing purposes.

MARKETING FOR PRIVATE INVESTORS

As it is difficult to reach out to private investors “en groupe”, networking will be the most important marketing tool for reaching out to private investors. Building personal relationships with (U)HNWIs and word-of-mouth marketing will be essential techniques to appeal to private investors. For instance, relationships can be actively built through inviting potential investors to art- or finance related events, such as art fairs, financial roundtables, etc. As mentioned earlier, the private investor target group will be primarily directed at art collecting individuals. The collector database or investor “rolodex” –that will be developed and continuously updated– will therefore be the most valuable asset for reaching out to private individuals. This rolodex will be put to usage through activities such as follow-up calls after meeting potential investors. In addition, THE AAART FUND aims to collaborate with private wealth managers and family offices. There are several institutions (e.g. Citi, BBVA) that offer art advisory services to their (U)HNWIs. These clients might be interested in investing in art through investment vehicles such as THE AAART FUND. A collaboration between THE AAART FUND and such companies therefore could be a great opportunity for both parties. The possibilities for collaboration will be explored once the fund is actually launched.

THE AAART FUND VALUES / GUIDING PRINCIPLES

As part of this marketing plan, several values have been established, which will serve as guiding principles in describing and selling THE AAART FUND to potential investors. These company values define the core pillars of the corporate identity and will assist in presenting the fund to external parties. These values do not only relate to the fund's marketing activities, but rather are the fundamental beliefs upon which the business and its behavior are based.



SECTION V: FINANCIAL PLAN

FINANCIAL PLAN / BUDGETING AND FORECASTING

A special note regarding this section: All information presented in the various financial statements are based on estimates. The financial plan is about making forecasts about the future through “guesstimating” certain numbers. Since the following objectives and calculations are all based on predictions, numbers are subject to change.

REVENUE MODEL / HOW MONEY IS MADE

THE AAART FUND LLC’s revenue streams depend on the number and size of investments in the fund. As mentioned in Section II: THE AAART FUND (p. 12), the fund aims for a fund size of \$50 million AUM. Investors will be charged a “2 and 20”-fee, that is, (i) an annual management fee of 2% of the net asset value of the fund’s art portfolio and (ii) a 20% performance fee on earnings above the hurdle of 7%. The performance fee, however, is considered a “bonus” and is thus not taken into account in calculating the revenue streams. This provides a conservative yet reliable financial forecast.

Based on the most simple calculation, THE AAART FUND LLC can count on an annual revenue stream of \$1,000,000, which is based on a 2% fee over a full fund size of \$50 million. However, it is not realistic to expect a full investment capacity –an AUM of \$50 million– in year 1. It takes time to attract investors and fill up the fund. THE AAART FUND LLC therefore strives to be on a full investment capacity in year 3. The following sales objectives are set to achieve full capacity:

- Year 1: Attracting \$10 million in investments (i.e. \$10million AUM).
- Year 2: Attracting an additional \$18 million in investments (i.e. \$28million AUM).
- Year 3: Attracting an additional \$22 million in investments (i.e. \$50million AUM).

Given these objectives, THE AAART FUND LLC expects the following annual revenue streams:

PERIOD	CALCULATION	ANNUAL REVENUE
YEAR 1	$\$10,000,000 \times 2\% =$	\$200,000
YEAR 2	$\$28,000,000 \times 2\% =$	\$560,000
YEAR 3	$\$50,000,000 \times 2\% =$	\$1,000,000
YEAR 4	$\$50,000,000 \times 2\% =$	\$1,000,000
YEAR 5	$\$50,000,000 \times 2\% =$	\$1,000,000
YEAR 6	$\$50,000,000 \times 2\% =$	\$1,000,000
YEAR 7	$\$50,000,000 \times 2\% =$	\$1,000,000
YEAR 8	$\$50,000,000 \times 2\% =$	\$1,000,000
YEAR 9	$\$50,000,000 \times 2\% =$	\$1,000,000
YEAR 10	$\$50,000,000 \times 2\% =$	\$1,000,000

The fact that the revenue calculation as presented on the previous page does not include the performance fee, deserves some extra attention. The performance fee drives the fund manager to achieve above average returns. This means that the performance fee is an important determinant for the generation of revenue. The reason for ignoring this fee in the financial plan, however, is the difficulty of accurately estimating such above-average performance. The fact that it concerns *above-average* returns explains that this sort of income is extraordinary and therefore cannot be perceived as *guaranteed* in estimating revenues.

Although the performance fee is perceived as a “bonus” in financial terms, the fund manager will do his utmost best to achieve returns above the 7% hurdle at any time. Both the investors in the fund as well as the fund itself benefit from above-average performance. The extra income resulting from the performance fee will substantially contribute to the fund’s actual total revenue. As such, it is fair to assume that THE AAART FUND LLC will collect more revenue than budgeted for in this financial plan.

In addition to the extra revenue resulting from the performance fee, there are other alternatives to increase total revenue. In case of disappointing performance THE AAART FUND LLC could consider to utilize the fund’s assets more actively. For instance, artworks could be loaned to either investors in the fund or even museums or other institutions. An interest rate can be charged for loaning out the artworks, which brings in an additional revenue stream. It could be especially interesting during the fund’s “hold”-period (year 4 to 7), as the fund manager’s activity is fairly low during that period. The art insurance policy might have to be adjusted though.



Roni Horn, *Untitled* (“A dream dreamt in a dreaming world is not really a dream ... but a dream not dreamt is.”), 2012. © Roni Horn, courtesy of Hauser & Wirth.

INCOME STATEMENT / INCOME VS. EXPENSES

The expected revenue streams presented in the revenue model serve as the starting point for THE AAART FUND LLC's income statement. Various costs items are subsequently deducted from total revenues in order to end with an operating income (i.e. a profit or loss). Evidently, THE AAART FUND LLC expects losses in the first 3 years. There are two important reasons for this:

- A) Total revenue is significantly lower in the first two years;
- B) Several cost items are higher in the early years, because they either involve "start-up" costs (e.g. legal fees) or are inherent to the investment cycle of the fund (e.g. art transportation costs are substantial in the early years because all art acquisitions will take place in that period).

As a result of these significant costs, THE AAART FUND LLC is projected to break-even after year 3 and end year 4 with a profit. Note however that the operating income is expected to be higher than the numbers presented below as total revenue is expected to be higher (due to the ignorance of the performance as explained on the previous page). It is simply impractical to guesstimate performance-based revenues, especially in the fund's early years of existence. It is also unrealistic to make very long-term prognoses. Therefore, this income statement only considers the first four years of operation of THE AAART FUND LLC. These are the most crucial years though, because from year 4 onwards the forecast is supposed to be very similar for at least 3-4 years. That is because this income statement assumes the THE AAART FUND will be at full capacity at the end of year 3 (i.e. an AUM of \$50 million *and* a "fully" invested fund). For instance, the costs for art investment/divestment are estimated to be zero in year 4, because from that point onwards the fund will no longer acquire artworks but rather hold onto inventory for about four years (before divestments commence). This example explains that some costs decrease over time, whereas others increase due to the nature of the fund. For more in-depth analysis, please refer to a more detailed version of this income statement in the Appendix (p. 38-39).

	YEAR 1	YEAR 2	YEAR 3	YEAR 4
TOTAL INCOME	\$200.000	\$560.000	\$1.000.000	\$1.000.000
LABOR COSTS	\$510.000	\$483.050	\$496.492	\$510.336
OFFICE COSTS	\$67.300	\$59.800	\$57.300	\$57.300
ART IN/DI-VESTMENT COSTS	\$60.000	\$108.000	\$132.000	\$0
ART STORAGE COSTS	\$148.800	\$264.800	\$348.800	\$128.800
OPERATION COSTS	\$18.120	\$18.120	\$18.120	\$18.120
MARKETING COSTS	\$56.850	\$54.650	\$53.650	\$52.150
EXTRA COSTS	\$50.000	\$50.000	\$50.000	\$50.000
TOTAL EXPENSES	\$911.070	\$1.038.420	\$1.156.362	\$816.706
OPERATING INCOME (BEFORE TAXES)	-\$711.070	-\$478.420	-\$156.362	\$183.294

START-UP CAPITAL / HOW MUCH MONEY IS NEEDED

The income statement clarified that a large sum of money is required to run THE AAART FUND LLC. As a result of the nature of the business, most (financial) activity takes place in either the early or the late years of the fund's ten-year holding period. Expenses are highest in the early years because this is the period in which the fund's assets are acquired. Moreover, startup costs also lead to an increase in total expenditures in the first year. In order to counterbalance the early expenses and foster sales, external investment is needed. THE AAART FUND LLC will not be able to launch the business without receiving seed capital from angel investor(s).

Potential angel investors are offered to invest in THE AAART FUND LLC through a convertible loan. This is a form of short-term debt which can potentially be converted into equity. Convertible loans offer more security, as lenders can claim to become shareholders in THE AAART FUND LLC in case of overdue interest payments or disappointing performance of the firm. Interest rates of the convertible loan are not communicated yet as these are negotiable, but the rate will obviously be competitive. Other terms of the loan agreement, such as the maturity date and frequency of payments, are also subject to negotiation.

Additions or adjustments to this investment structure can be discussed as well. For instance, splitting the income resulting from the performance fee might be another condition to agree upon the loan terms. THE AAART FUND LLC is open to negotiate alternatives to the regular convertible loan structure. What is paramount for THE AAART FUND LLC is that potential angel investors should believe in the business model as presented in this document.

Based on the income statement, THE AAART FUND LLC will need approximately \$3 million in seed capital. Such an investment would allow the company to cover all expenses of the first three years of operation. Financial support up to the break-even point (which presumably lies between year 3 and 4) is crucial for building a sustainable business. The loan sum, however, can be issued in multiple stages (e.g. a \$1 million loan at start followed by 2-4 other smaller tranches in year 2 and 3). THE AAART FUND LLC does not require to receive the full amount at once. This gives the lenders the flexibility to spread their capital investment. Moreover, multiple issue dates also provide fixed time slots for financial evaluation.

APPENDIX

INCOME STATEMENT / EXTENDED VERSION

	YEAR 1	YEAR 2	YEAR 3	YEAR 4
INCOME				
Management fee	\$200.000	\$560.000	\$1.000.000	\$1.000.000
Performance fee	\$0	\$0	\$0	\$0
TOTAL INCOME	\$200.000	\$560.000	\$1.000.000	\$1.000.000
LABOR COSTS				
Director salary	\$90.000	\$92.700	\$95.481	\$98.345
Fund manager salary	\$120.000	\$123.600	\$127.308	\$131.127
Portfolio manager salary	\$120.000	\$123.600	\$127.308	\$131.127
Investor relations manager salary	\$70.000	\$72.100	\$74.263	\$76.491
Office manager salary	\$35.000	\$36.050	\$37.132	\$38.245
Accounting/tax fees (external advisor)	\$20.000	\$15.000	\$15.000	\$15.000
Legal/compliance fees (external advisor)	\$55.000	\$20.000	\$20.000	\$20.000
TOTAL LABOR COSTS	\$510.000	\$483.050	\$496.492	\$510.336
OFFICE COSTS				
Office rent	\$36.000	\$36.000	\$36.000	\$36.000
Utilities (i.e. gas and electricity)	\$4.800	\$4.800	\$4.800	\$4.800
Amenities (e.g. internet and telecom)	\$0	\$0	\$0	\$0
Office furniture	\$0	\$0	\$0	\$0
Office equipment (e.g. computers)	\$15.000	\$7.500	\$5.000	\$5.000
Office supplies (e.g. pens and paper)	\$3.500	\$3.500	\$3.500	\$3.500
Kitchen/pantry supplies (e.g. coffee and cookies)	\$1.000	\$1.000	\$1.000	\$1.000
Cleaning costs	\$6.000	\$6.000	\$6.000	\$6.000
Office maintenance/repair costs	\$1.000	\$1.000	\$1.000	\$1.000
TOTAL OFFICE COSTS	\$67.300	\$59.800	\$57.300	\$57.300
ART IN/DI-VESTMENT COSTS				
Transaction costs (e.g. auction BP/SC)	\$50.000	\$90.000	\$110.000	\$0
International transaction costs (e.g. import fees)	\$10.000	\$18.000	\$22.000	\$0
Appraisal costs	\$0	\$0	\$0	\$0
TOTAL ART IN/DI-VESTMENT COSTS	\$60.000	\$108.000	\$132.000	\$0
ART STORAGE COSTS				
Delaware Freeport rent (secured warehouse)	\$28.800	\$28.800	\$28.800	\$28.800
Transportation costs (i.e. crating/shipping of artworks)	\$100.000	\$180.000	\$220.000	\$0
Art insurance costs (incl. shipping insurance)	\$20.000	\$56.000	\$100.000	\$100.000
Art conservation/maintenance/repair costs	\$0	\$0	\$0	\$0
TOTAL ART STORAGE COSTS	\$148.800	\$264.800	\$348.800	\$128.800
OPERATION COSTS				
Bank account fees	\$600	\$600	\$600	\$600
Art management system (e.g. Artbase)	\$2.520	\$2.520	\$2.520	\$2.520
Data analytics (e.g. ArtRank)	\$14.000	\$14.000	\$14.000	\$14.000
R&D subscriptions (e.g. ArtPrice and Artnet)	\$1.000	\$1.000	\$1.000	\$1.000
TOTAL OPERATION COSTS	\$18.120	\$18.120	\$18.120	\$18.120

	YEAR 1	YEAR 2	YEAR 3	YEAR 4
MARKETING COSTS				
Website development and maintenance (incl. hosting)	\$850	\$150	\$150	\$150
Professional printing (e.g. prospectus and reports)	\$2,000	\$1,400	\$1,000	\$400
(International) mailing (e.g. prospectus and reports)	\$3,000	\$2,100	\$1,500	\$600
Annual travel (roadshows)	\$40,000	\$40,000	\$40,000	\$40,000
Extra travel (e.g. conferences)	\$5,000	\$5,000	\$5,000	\$5,000
PR matters	\$2,000	\$2,000	\$2,000	\$2,000
Networking	\$4,000	\$4,000	\$4,000	\$4,000
TOTAL MARKETING COSTS	\$56,850	\$54,650	\$53,650	\$52,150
EXTRA COSTS				
Reserve for unforeseen costs	\$50,000	\$50,000	\$50,000	\$50,000
TOTAL EXTRA COSTS	\$50,000	\$50,000	\$50,000	\$50,000
TOTAL EXPENSES	\$911,070	\$1,038,420	\$1,156,362	\$816,706
OPERATING INCOME (BEFORE TAXES)	-\$711,070	-\$478,420	-\$156,362	\$183,294



Sam Gilliam, 10/27/69, 1969. © Sam Gilliam, courtesy of MoMA.

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