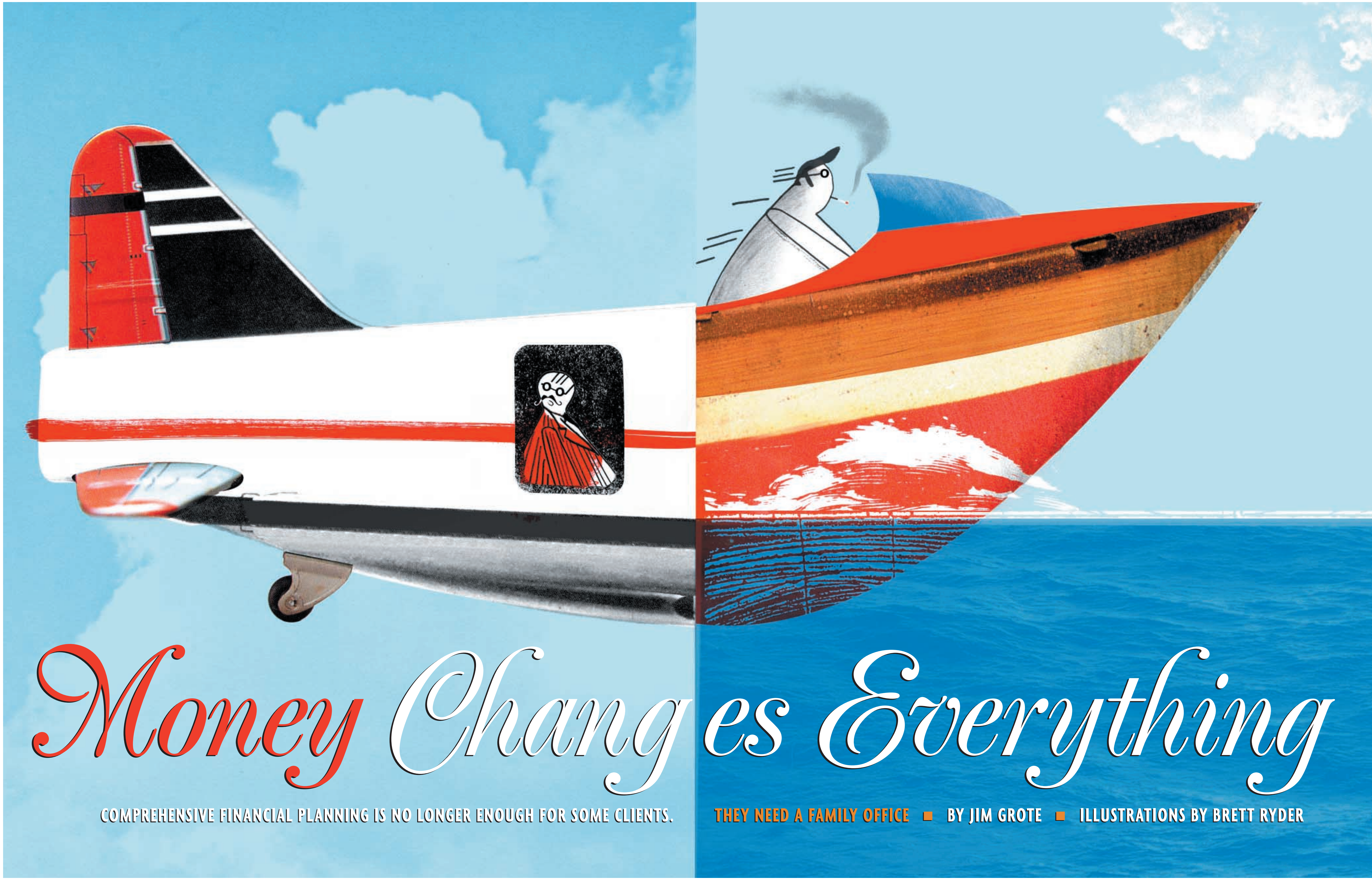
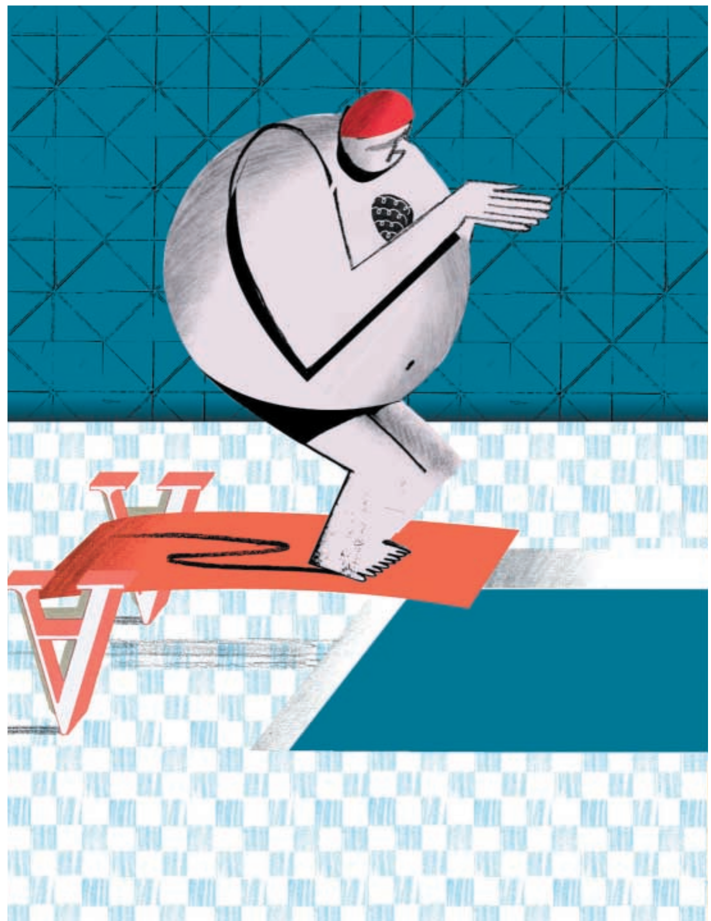


Money Changes Everything

COMPREHENSIVE FINANCIAL PLANNING IS NO LONGER ENOUGH FOR SOME CLIENTS. THEY NEED A FAMILY OFFICE ■ BY JIM GROTE ■ ILLUSTRATIONS BY BRETT RYDER

Face it, however bad the markets have been these past three years, lots of wealth was created in the 1980s and '90s. Advisers know this firsthand. They've watched some of their merely well-to-do clients become extremely wealthy, particularly business owners that benefited from a liquidity event and corporate chieftains who exercised stock options during the rah-rah years in equities.



And, money does change everything. Asset management and even comprehensive financial planning are just pieces of what these newly wealthy clients feel they need. Not wanting their money to be a burden, they are asking about bill paying, property management, and various concierge services. No longer worried about funding retirement, they've begun to think of their wealth as a legacy that can be preserved to serve their progeny, perhaps even their community or the nation, for generations. These clients have grown and in the process are creating a challenge for their advisers, asking them to grow also and provide these services. The adviser unwilling or unable to respond is likely to lose these clients of long standing to an adviser who will, or to a private client group at a bank or brokerage. For advisers who want to keep and serve these clients, who are willing to expand or in some cases reinvent their practice, the multifamily office is a logical model to adopt.

According to the Family Office Exchange (FOX) in Oak Park, Ill., a clearinghouse for high-net-worth families and the advisers who serve them, a properly designed single- or multifamily office seeks to

1. perpetuate family continuity by providing leadership training for future generations and 100-year goal development for families
2. develop a strategic approach to philanthropy by creating clear missions and goals and making effective grants
3. oversee risk management by assessing and reducing risk in the broadest sense—including investment risk, insurance needs, and personal security issues
4. ensure diversification by managing investment selection and allocation strategies and create systems to monitor performance
5. create an integrated plan that includes wealth-transfer strategies, proactive tax planning, and optimal ownership structures (for example, limited-liability companies, family limited partnerships, and various trusts)
6. provide lifestyle management that consolidates reporting, bill paying, and property management of homes, boats, and airplanes

FOX's founder Sara Hamilton says that the multifamily office requires sophistication in most of these areas. At a minimum, Hamilton thinks an adviser who wants to evolve in the direction of the multifamily office needs to add integrated planning (including estate, tax, and financial planning) and lifestyle management. A broad-based approach to risk management is also key to serving wealthy clients, she says.

How much family wealth is required to justify these levels of service? Hamilton calculates that for a single-family office to be viable, the client should have at least $100 million in liquid assets. That may sound high, but consider that the single-family office executive commands a minimum of $200,000 a year. Add in other professionals and support staff (not including money managers), benefits, office space, hardware, software, and the money you get from charging, say, 60 basis points on $100 million is suddenly stretched pretty thin.

Despite the costs, the family-office concept is growing.

According to the Family Office Exchange, the number of dedicated family offices in 1990 was between 500 and 1,000, whereas today there are more than 3,500. Still, wealthy families' desire for privacy means that no one really knows how many family offices there are. In contrast to FOX's estimate, Cerulli Associates stated in a July 2001 report that there are between 3,000 and 5,000 family offices in the United States.

One advantage to setting up an office that serves more than a single family is the drop in entry price, which FOX estimates to be around $20 million in liquid assets for each family. Still, assuming a fee of 60 basis points, this isn't necessarily the road to riches for a small advisory firm. Although five families will give you the $100 million under management—which Hamilton pegs as the minimum for a single-family office—10 families with at least $20 million each, for a total of $200 million or more, might be a more viable business model. The good news is that there are a lot of prospects for such services, even above the $20 million level. According to Merrill Lynch/Cap Gemini Ernst & Young's *World Wealth Report 2002,* 18,000 individuals in the United States had assets of $30 million or more in 2001. "This is a substantial market in terms of what it has to offer, and that's why so many people are interested in it," says Hamilton.

Ironically this drop in entry price for the client has not corresponded with an increase in multifamily offices. Today there are only 50 U.S. multifamily offices in the Family Office Exchange's directory, but then again that low number may reflect its rigorous criteria. Pete Wheeler, founder of the FamilyOfficeNetwork in San Diego, an on-line virtual family office, estimates there are "several hundred investment-advisory firms offering multifamily services to at least some of their clients." These firms might take clients with as little as $5 million. Hamilton questions whether such clients meet the profile for a multiclient family office, however. "Do they have an intergenerational plan?" she asks. After all, $5 million may not make it to the next generation.

Still, as Charlie Haines, principal at Charles D. Haines, LLC, a multifamily office in Birmingham, Ala., points out: "All family offices become multifamily offices by the fourth generation because of the number of family members and the difference in values among the subfamilies. Furthermore, there is a natural pollination by outside families marrying into the original family."

Indeed, multifamily offices generally have their roots in one of two business models: either they are started from scratch, or, as Haines suggests, they grow out of a dedicated family-owned office.

An example of a company that has taken the first path is TAG Associates in New York. TAG was founded in 1983 by tax partners from Ernst & Young, the New York accounting firm, with the express mission of building a multifamily office. The firm's first major clients were executives from Warner Communications, and the firm continues serving senior executives at AOL Time Warner today. According to Stanley Pantowich, chief executive officer, the firm's services comprise portfolio management, tax planning, financial reporting, bill payment, philanthropy, estate planning, and a variety of concierge services, including household administration. The firm's 60-person staff manages the financial affairs of 80 families with more than $3 billion in assets. Traditional diversified investments, with an emphasis on value, account for $2 billion of these assets, whereas $1 billion is in hedge funds of a very conservative nature—primarily those with an emphasis on relative-value arbitrage. All investments are managed through third-party money managers.

Vogel Consulting in Brookfield, Wis., is another multifamily office that started from scratch. Founded by Rhona Vogel eight years ago, the firm now serves 18 families with an average net worth of $100 million. Vogel say her goal is ultimately to serve 25 families.

"I had been a partner at Arthur Andersen, working with high-net-worth families who had experienced recent liquidity events and were being inundated by salesmen from multiple disciplines. These families were looking for a one-stop shop offering independent advice," says Vogel. In order to maintain objectivity, Vogel outsources the management of the clients' $3.6 billion in assets. The inhouse staff comprises 22 professionals and six support personnel, including one certified financial planner licensee and seven certified public accountants. Along with overseeing third-party investment managers, the services offered by Vogel Consulting include bill paying and cash management, advice on private equity as well as other alternative investments, and comprehensive tax management. Because Vogel has a number of clients currently operating companies, the tax work includes corporate, individual, and trust tax planning and preparation. "We don't like to farm out tax work," says Vogel. "We like to keep close tabs on our client's tax situations at all times. And we tend to integrate our estate planning with our tax work." In addition, one person at the firm oversees the cost-containment side of client-brokerage trading. Another focuses on insurance-product analysis, particularly health insurance for family members who are not employed. And one support staff member provides concierge services.

High tech alone won't win hearts and minds—you also must be high touch

Vogel views her work as more creative than typical wealth-management work. "It's an opportunity to work with fascinating people and acquire a broad, well-rounded financial perspective," she says. However, Vogel points out that this creativity is expensive to maintain. "A multifamily office is much more complex than people would imagine, requiring sophisticated and expensive information systems. For example, the personal general-ledger package for the family must be integrated with investment account–aggregation software and tax software."

Not that high tech alone wins the hearts and minds of clients. The would-be multifamily office must be high tech and high touch, says Vogel. "Every one of our family relationships is customized to the family. We're big on regularly scheduled meetings with family decision makers, sometimes as often as biweekly," she notes.

High-touch service is also something that's emphasized by multifamily offices that have evolved from single-family offices. Among these are Bessemer Trust Co. in New York; Pitcairn Trust Co. in Jenkintown, Pa.; and Laird Norton Trust Co. in Seattle. Bessemer Trust is probably the largest multifamily office that originated as a single-family office. It was launched in 1907 to serve members of the Phipps family. Henry Phipps, the patriarch, was a partner with Andrew Carnegie in the steel business. Bessemer began to take on other wealthy families as clients in 1975 and today has a roster of approximately 1,800 clients with about $36 billion in assets. (For more on Bessemer Trust, see "Where Old Money Meets New," June 2000.) Pitcairn Trust, formed in 1923 to manage the assets of the descendants of John Pitcairn, founder of the Pittsburgh Plate Glass Co., invited in other families as clients in 1990. Today it has more than 300 clients with more than $2 billion under management.

Compared with Bessemer and Pitcairn, Laird Norton Trust Co. is a relative newcomer to the world of family offices. Although it can trace its roots back to 1855, when two brothers from the Norton family and a cousin from the Laird family went into the lumber business in Winona, Minn. (they later joined forces with Frederick Weyerhaeuser's timber ventures on the Pacific Coast), it wasn't until around 1955 that the company also began to function as a family office, delivering trust and investment services to the Laird and

Norton families. Laird Norton Trust Co. first opened its doors to other families in 1979 and now has more than $2 billion under management.

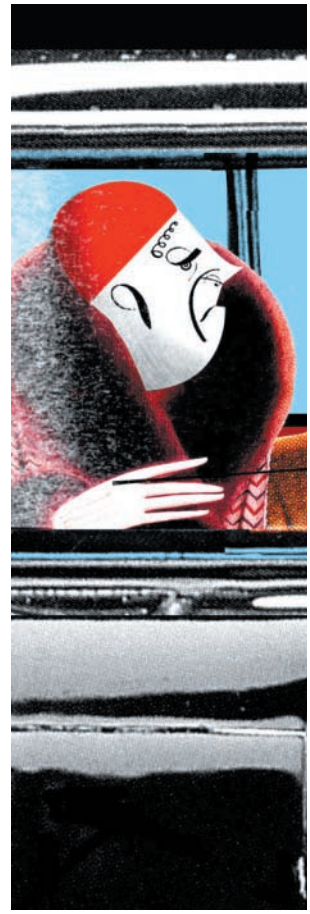
One of the firm's biggest worries in opening its doors to new clients, says Deborah Bevier, chief executive officer, was how to maintain absolute confidentiality within the multifamily office model. The Laird and Norton families created the original family office in part to ensure confidentiality about financial matters.They sought out investment managers who would work exclusively for the two families. When the decision was made to accept outsiders as clients, members of the original families worried that the confidentiality they worked so hard to protect might be breached. Ultimately this concern was addressed by strict agreements between the firm and its new clients asserting that no client information can be shared with any other Laird Norton Trust client.

Interestingly, this emphasis on confidentiality wound up tying in well with what most new clients were looking for, says Bevier—a more personalized and in-depth level of service than what they could find at a larger firm, such as a national bank. Maintaining confidentiality, however, poses a continuing challenge for all family offices. Which may be one reason why Laird Norton lays great stress on employee retention.

As Bevier explains, "Employee turnover is a serious negative in this business. The longevity of our employees is especially important because our employees are privy to so many 'soft' family issues." These soft issues include problems that can confront any family, such as divorce, as well as issues unique to wealthy families—such as teaching offspring the value of work when it's not a necessity, imparting a tradition of philanthropy and volunteering, and avoiding conspicuous displays of wealth.

Laird Norton has 100 employees serving about 300 families. Each family group is served by a client-service team headed by a certified trust and financial adviser, who acts as fiduciary and primary client contact. A portfolio manager, who is a chartered financial analyst, manages the family's customized portfolios as well as any outside money managers required by the relationship. A wealth adviser, usually a certified public accountant or a certified financial planner licensee, provides financial and tax planning. Team leaders are frequently also attorneys or have other professional designations. These client-service teams are in turn supported by specialty teams, says Bevier—including a business planning and succession team, a tax planning and preparation team, and an investment team. The business and tax teams handle some services in-house, but often partner with a client's existing advisers, such as accountants and attorneys.

It is a sign of the times, however, that regardless of the path they took to become multifamily offices, a number of firms are partnering with large financial-services institutions. U.S. Trust Co. in New York—founded in 1853 by 10 families and the granddaddy of all multifamily offices—was acquired by Charles Schwab Corp. in 2000. Its Family Wealth Management group, which serves families with portfolios in excess of $50 million, now has $87 billion in assets under management.



Asset Management Advisors in Palm Beach Gardens, Fla., which was launched in 1989, was bought by SunTrust in 2001. It now has 100 client families with $3 billion in assets which it manages through two subsidiaries. And Frye-Louis Capital Management in Chicago, founded in 1992 by members of the S.C. Johnson Wax Cos., was bought by Credit Suisse Private Banking last year.

What advice do executives at multifamily offices give to advisers who are thinking about venturing into the business? The Family Office Exchange's director of market development Tom Livergood, for one, warns advisers not to underestimate the cost and the hassle of providing concierge services. One adviser who was considering the multifamily office model told him, "We don't want to institute a dog-walking service"

Yet concierge services may be a top priority for some wealthy families. In the past, dedicated family offices may have emphasized such services more clearly than they do now. Anne Etheridge, administrative director of the Norton Family Office in Santa Monica, Calif., says, "Many modern family offices are too investment driven; they need more of a balance. Investment managers and attorneys often look down their noses at concierge services, but it's a very complicated business, and it has to run like a well-oiled machine." Certainly, as clients move from well-to-do to merely wealthy, the appeal of finding ways to make their lives less complicated increases.

Kathy Longo, a principal at Accredited Investors in Edina, Minn., tells a sobering story for advisers who are thinking of starting up a multifamily office. Prior to her current job, she worked for Family Financial Strategies in Minneapolis, which had started as a dedicated family office and lasted only four years as a multifamily office. The problems began when the old-money family that the firm had served for years sold its interest in the business to the executives who were running the company. The original family remained as a client of the

Old-money and new-money families desire different services and need different systems to deliver them

new multifamily office. And the new owners brought in new families as clients—families whose wealth was relatively recent and had come primarily from selling their businesses. From the outset, says Longo, there was a clash between the old-money culture and the new.

Different family cultures, Longo explains, desire different services and need different systems to deliver them. New-money families take the stewardship of their wealth very seriously, and they require a high degree of control and instant access to information about their investments. They also resist letting go of mundane tasks like bill paying, says Longo. By contrast, members of old-money families often don't read their financial statements. They don't care about high-tech instant access to financial information, and they love concierge services, including bill paying. As a result, serving old money is more labor intensive—and expensive—than serving new money. But the latter requires more high-priced technology tools.

Still, the biggest challenge for a multifamily office may be an existential one. Bevier points out that to be truly successful, a multifamily office must provide the glue that keeps wealthy families together. To that end, Laird Norton organizes annual family meetings, which function as business meetings, educational briefings, and family-sharing sessions. The firm also encourages the establishment of charitable foundations, which foster family identity and strengthen family relations with the local community. Laird Norton also encourages the regular revision of family mission statements. The importance of these soft issues to a wealthy family cannot be underestimated, says Bevier. Families of significant wealth are as interested in preserving their family legacy and identity as they are in preserving their assets. Comprehending this is the most important step independent financial advisers contemplating the multifamily office model need to take.

Jim Grote is a financial writer whose articles have appeared in Journal of Financial Planning, *MorningstarAdvisor.com, and* Planned Giving Today.