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Single Family Offices Facing a Transition

For numerous reasons, single-family offices are increasingly difficult to sustain, but there are options for families seeking alternatives

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In recent years, the number of single family offices has increased dramatically, along with an increase in wealth among Americans and their families. According to the Family Wealth Alliance, in the United States there are approximately 3,000 single family offices today versus approximately 2,500 in 2010, an increase of 20%, paralleling explosive wealth creation over the course of that time period.

Single-family offices take on numerous shapes and sizes, but the conventional wisdom is that a minimum of $500 million to $1 billion in family assets is needed to run a robust, full-service office. The advantages of a single-family office with a certain level of assets are many – families have total control over how it is run; they have total privacy and discretion; there are no conflicts and the service is as good as the family wants it to be.

Additionally, increased concerns about control and privacy (post-2008) have added to this surge in the creation of new offices. Ultra-wealthy families, who, at one time, may have been comfortable with private banks and larger multi-family offices, have been put off by many of the issues large banks had during the financial crisis. They are finding that having their own staff that they can trust is of paramount importance. And several new family offices have resulted from the closing of hedge funds to outside investors, such as those transitions made by Steve Cohen and Stanley Druckenmiller.

And yet, this increase in the number of single family offices comes at a time when maintaining a single family office is as difficult as it's ever been. More than ever before, significant resources are needed to run a single-family office, and that makes maintaining one a serious challenge for some families.

Challenge to SFO Sustainability

Single family offices typically and increasingly find that they face significant sustainability issues due to a number of factors.

Many of the below factors have caused the expense level of maintaining the family office to rise considerably. If the cost of running a single family office reaches 1% to 2% of the family assets, as many offices do, this can be a significant burden on keeping the family's wealth intact after taxes, inflation and manager and other fees. This expense pressure could become even more of an issue should investment returns be less attractive than they have been in recent years. Many of the following can drive costs up:

1. The aging of the founding family generation. As the initial founder(s) of the family office age, leadership, and even mission, come into question. A family office started by the patriarch was frequently driven by a liquidity event, which resulted in an immediate need for management of new liquid wealth. As the next generation reaches maturity and have assets in their own names, their views on the mission, expense, services provided and staffing can differ from those of the original founding generation. The expertise, interest and commitment may not reside with one family member. While a non-family member can be the day-to-day office head, the family's supervision and leadership is important for continued family commitment and harmony. Sadly, most family offices do not have a clear succession plan for their office.
2. The aging of the staff head of the family office. Often, the senior staff member of the office is of the same generation of the founder. The retirement of the office head often occurs without a clear successor in-house, due to expenses and

lack of an obvious replacement. Selection of a successor that appeals to the next generation can also be a difficult process.

3. The need to serve many more households than the original founders. As families branch out, it creates a dynamic where the family office has the same amount of assets to manage, but a larger client roster. Additional clients means staffing needs to increase, which puts additional pressure on overall expenses.

4. Increasing service requirements to include more than core investment, tax and accounting services. Wealthy families are often looking for more from their advisors, including concierge services and lifestyle management, health and elder care advisory, property management and family governance and education services. Single family offices can rarely provide those types of services without outsourcing, and even outsourcing can become burdensome for smaller single family office staffs.

5. Increased complexity and scope of investment, tax, regulatory compliance, and other issues. Family offices of all sizes have to seek out all possible investment opportunities, which means creating and compensating a robust investment staff that knows how to select hedge fund and private equity managers, as well as how to evaluate other investment ideas and even make direct co-investments in private companies, something that's becoming more and more popular. Additionally, regulatory and compliance burdens have increased, and though single-family offices have some regulatory exemptions, some of those may not be around forever.

6. Cyber security concerns. Single-family offices are highly valued mainly because of the discretion and privacy they offer. But handling wealth means it is absolutely critical to have the best and most secure systems available, and be up to speed on all security threats. This can be costly and time consuming.

Alternatives to Single Family Offices

A significant number of complex services are required to effectively advise families, and even outsourcing many of those services can leave gaps in what a single-family office provides. There's still a significant amount of work and commitment required, no matter how much is outsourced. Outsourcing has become a more and more difficult course on which to proceed. Most single family offices typically include the following services:

- Investment management
- Income tax planning and compliance
- Estate planning
- Financial planning, including cash flow planning and management and preparation of financial reports
- Philanthropic advice and management
- Risk management including property, casualty, liability and life insurance
- Trustee services, either individual family members, staff members or the family office coordinate
- Family governance, family meeting, and providing next generation education
- Concierge service such as travel arrangements, household staffing and others

There are certainly numerous outsourcing options for family offices to consider for any of these services that they do not have the bandwidth to provide. But the need to select appropriate providers and monitor their activities can still be quite a time consuming task. In fact, many existing single family offices have experienced "service creep," whereby outsourcing becomes a significant task in and of itself, which exacerbates the expense of and professional skills required to continue to operate the family office for the founding family.

Beyond the prospect of increasing the amount of outsourcing single family offices can do, the challenges remain significant, and many family offices have begun to consider various alternatives available to them to best serve the family going forward. These alternatives include the following:

- Partner with a multi-family office to provide services that are not currently provided. This can involve anything from teaming up on investments to each office providing services to the other that are not currently available.
- Merge with another single family office to achieve better economies of scale. Just like any merger of similar companies in any industry, having more resources can improve margins.
- Close the office and help family members find their own advisor. Sometimes, this can be the preferred option for family members who prefer and are prepared to go their separate ways.
- Open the doors to become a multi-family office by serving other families to build scale and improve margins. Another way to scale the business, by growing it by inviting clients from outside the founding family to join.
- Become a virtual family office, with a skeleton staff working remotely that can significantly cut down on costs.

Each of these solutions has clear advantages and disadvantages related to control, expense, service expectations and level of family involvement. The only way forward is, if the single family offices is not sustainable, to discuss with family members what their priorities are and the best way to move forward in order to maintain their wealth and their legacy.

Alternative Solutions: The Pros and Cons

Option	Pros	Cons
Outsourcing	• Continuity with core staff and services	• Can create service gaps • Eventually becomes costly
Merger with another SFO	• Better economies of scale, improve resources	• Share staff with another family • Cultural fit with staff and families could be issue
Close the SFO	• Sometimes the only possible solution for disparate families	• Loss of scale and family coordination and unity
Become MFO	• Can help bring in assets and build scale • Maintain same staff and possibly increase services	• New families may not be a cultural fit • Founding family may feel privacy, autonomy lost
Virtual FO	• Non-centralized office can save costs	• Difficult to replicate high service factor of SFO
Shared Family Office	• Ownership structure means all clients equal • Can increase scale, save costs, create sustainability without fee increase	• Finding clients that fit can be challenging

There are an increasing number of multi-family offices for the single family office to consider joining, though the difficulty for some families is the loss of privacy and identity of having their own office. Further, many of the larger multi-family offices are "embedded" in larger multiservice institutions, such as banks or brokerage firms, and are not the main focus of the institution. These institutions exist to drive profit,, and look at ultra-high net worth families as merely a source of additional revenues, with little regard for stewarding family legacy and philanthropy goals. Additionally, the culture of these firms is more typical of big financial institutions, which are often public, that place profits over acting in the clients' best interest.

The Shared Family Office Solution

One other model has emerged, albeit infrequently, in the family office industry, called the "shared family office." It can be particularly attractive to families with their own office that may be facing a transition from their single-family office.

Under such a structure, each client family becomes a shareholder in the family office partnership. What it should provide is some influence over the firm's mission and direction, including an assurance that the company is aligning its interests with those of its clients.

While some level of corporate profitability is needed to attract and retain staff and to reinvest in the infrastructure of the business, it should not be a separate goal that can potentially drive non-client-centric actions such as aiming for excessive growth, charging higher fees and thinking short term rather than long term. All of these pursuits can results in conflicts of interest, which is exactly what many families are seeking to avoid.

Another benefit of such a structure is the ability to maintain the feel and culture of a single family office. This is naturally appealing to a family that has become accustomed to this type of culture in the past, and in fact likely chief among the reasons why they stuck with their single family office for a long period of time.

Another benefit is the creation of a client network of interested, like-minded families who can regularly share their ideas and experiences concerning issues such as educating the next generation, philanthropy and family communication and legacy.

And finally, this type of approach could make it possible to take on valued staff from the client's previous family office to help with the transition and/or become a full-time employee.

Conclusion

Single family offices today face a number of possible threats to their sustainability. Despite growing wealth, their existence is increasingly threatened. Taking a family office approach for their wealth may still make sense to achieve coordinated management, but families may need to consider alternatives to their current structure, particularly in light of looming succession with the office's leadership. Understanding the family's key mission, alternative solutions available, and building consensus within the family will produce a better outcome.

All possible avenues should be explored, including even different types of structures, such as a shared family office model, that can provide families with a unique solution to moving from its current structure to a compatible and fully structured shared office.

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