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Not Just All in the Family

FAMILY OFFICES, WHICH OVERSEE OLD-MONEY WEALTH, HAVE TO CHANGE WITH THE TIMES.

As F. Scott Fitzgerald put it: The rich are different. As one might expect, this extends to the way they manage their wealth.

The ultra-rich don't bother with run-of-the-mill stockbrokers and financial planners. The select few—those with a minimum of \$100 million or so in assets—may choose to open what is genteelly known as a “family office.”

Depending on the charge from the founding family, these offices provide everything from tax and estate planning to legal services, management of charitable giving, trustee services, and foundation management. They generally employ experts to review the track records of money managers and select one or more to actually run the money. Some of the bigger offices (read “really, *really* rich”) have their own professional money managers on staff.

The first family office was established by the Rockefeller family in 1882. Since then, the convention has grown to embrace somewhere between 3,000 and 5,000 such establishments nationwide, with an estimated 30-plus family offices in the Twin Cities. Local examples

include Waycrosse for the Cargills, Okabena for the Daytons, Sargent Management for the Pillsburys and the Ankenys (which married into the Pillsbury clan), and the newer Olympus Ventures for the family of Richard Schulze, founder of Best Buy Company.

But change is sweeping this once quiet niche of the financial services industry. A combination of geographically dispersed third- and fourth-generation families, changing values and (surprise) money,

With costs rising and families growing, family offices want to function more efficiently.

are forcing mergers and acquisitions, technology changes, and new operational models designed to increase assets under management and increase fee income. More and more family members mean more legal and trustee services, more account management, more tax services, and so on. Bigger operations are needed.

Nationwide, family offices are flinging open their doors to outsiders, merging with other family offices, outsourcing various services and—oh, dear—launching PR campaigns to market their services.

This past January, for instance, Sargent Management announced that it was merging into the “multiple-family office” of the Sage Partnership in Edina (which had handled finances for several families), virtually doubling Sage’s assets under management. In April, Okabena announced that it would offer money management services to outside foundations and endowments. Even Rockefeller & Company—whose staff of 155 directly manages about \$2 billion in Rockefeller assets, another \$2 billion in non-

family funds, and \$7 billion in funds managed by outside advisors—has been pushing to transform itself into an upscale financial boutique.

“Some family offices are now in their fourth, fifth, and sixth generations,” says Mariann Mihailidis, a senior vice president with the Family Office Exchange, a Chicago-based professional ser-

vices firm for family offices in 17 countries. "Their wealth is spread out among more people. Costs keep rising, and family office senior management, board members, and family members are asking a lot of questions about how family offices can function more efficiently."

Perhaps the most common change, say Mihailidis and other experts, is the effort to broaden out the "customer base," becoming more like "friends-and-family offices."

Such is the case for Okabena, which has experienced many of the growing pains of the family office. Founded in 1969 by the five Dayton brothers, the office soon grew to serving the brothers and their 16 children. Now, roughly 90 family members from 30 or so households use Okabena's services.

Okabena is looking to add to its base of \$185 million of tax-exempt assets, offering its money management services, which consist of three highly diversified investment funds, to more clients. Specifically, it is pursuing a narrow slice of tax-exempt family foundations and endowments (low maintenance, high margin) of \$5 million and above, with a sweet spot in the range of \$10 million to \$30 million.

"We recognize that there's really a need in that marketplace," says Christine Galloway, Okabena's chief executive. "A lot of these organizations simply don't have the internal resources to meet their needs. The driving motivation is not necessarily profit; it's the perpetuation of what we have today."

But what many family offices have today are a plethora of problems: Families that have gotten very large, intense competition from a far more sophisticated financial services industry, and rising costs and technology demands.

The drive to stay competitive with other financial services firms was a significant part of the motivation earlier this year when Sargent Management merged with the Sage Partnership, which was established in 2003 through the merger of two smaller multifamily offices to provide wealthy families with estate, tax, and other wealth management services.

With the merger, Sage's assets under advisement—Sage, like Okabena and other offices, doesn't actively manage the money—ballooned to roughly \$1.5 billion. In return, Sargent picked up Sage's back office services and technology base, as well as access to sophisticated independent money management consultants who help Sage select money managers.

"After the second generation, the family tree starts growing faster than the assets, and the cost structure can get out of whack," says Jerry Johnson, chief operating officer for the Sage Partnership. "When a family office is servicing just four or five people, they might have 15 or 20 accounts. What happens when the office is servicing 40 or 50 people—more trust accounts, 529 plans for college, tax returns? You can easily end up with 700 accounts to manage."

Long before the Sage transaction, Sargent too had gone through a consolidation phase. "In addition to the demand for increased and more diverse services, the geographic dispersion of family members adds costs to the private family office," says Dick Townsend, who has managed the Sargent family office for 15 years. "Serving so many different generational needs strains the resources of a private family office."

In one survey of 54 family offices nationwide, the Family Office Exchange found that it cost an average of \$1.6 million a year, or

just under a half of 1 percent of assets under advisement, to run a typical family office. That translates to about \$480,000 to run an office with \$100 million in assets under advisement. (The Family Office Exchange's survey did not include investment management fees, which add another percentage point, or about \$1 million per year for a \$100 million office, to operating costs.) Other estimates of the cost range as high as 5 percentage points, putting any cost structure—including the overall returns from asset performance, which carry their own fees—under significant pressure.

One result of this, says the Family Office Exchange's Mihailidis, is the creation of family offices as new business ventures with a bottom-line focus from the beginning. "First-generation entrepreneurs setting up family offices are not only creating them to manage their own wealth, but they'll also go into it with the idea of making money," Mihailidis observes. "We're seeing the creation of new offices that offer either a broad or a limited array of services to other clients."

In the end, the bottom line is, well, the bottom line. "We realize that any of the family members being served by our office can take their assets and walk away," Okabena's Galloway says. "We are constantly trying to improve our services." ■

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