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HOW FAMILY OFFICES CAN BE MORE EFFECTIVE IN SECURING ALTERNATIVE INVESTMENTS

And why Family Offices Need to Dial Up a Dose of Humility

In January 2017 the investment world is a challenging place. Core equity markets now stand at record levels, bond yields at all-time lows and major property markets at or around historic highs too. Dowside risks appear everywhere with a potentially volatile geopolitical picture emerging.

Despite increases to the Fed rate, leaving cash on account in US banks is also not necessarily a viable option for investors looking for a proper ROI. This phenomenon is even worse in continental Europe with depositors being charged to keep money in banks, prompting some in Switzerland to build vaults to store physical cash. For those with money, they are faced not only what to do with their cash but also where and how to store it.

Family offices, particularly large single family offices ("SFO"), find themselves in a difficult position right now. Unlike large institutions that have little choice but to follow the herd, many SFO view their independence as an opportunity to take contrarian positions or make allocations in a more selective and nuanced way. Ultimately that may still result in asset allocations and positions that broadly match the majority of the investment management community. However, based on my experience most SFOs have a deeper allocation to alternative sectors when compared to a traditional pension fund, be that private equity, VC, senior debt or real estate or other alternative investment.

However, the challenge with alternatives is that there are regularly insufficient quality options available to investors. Those that are attractive get filled or snapped up very quickly. Instead of alternative managers/introducers having to sell themselves and their products to potential investors, investors need to find an edge so that they can get first call from the alternative manager or broker.

Having been in the family office investment community for about 6 years, I have some experience here. Both good and bad on my part. Much of what I'm about to say will sound like basic common sense, but I wasn't blessed with fantastic EQ and I'm afraid many in the Family Office community (at least many I know) aren't either.

When we established our family office, thanks to my background, we focussed on real estate. This has proved to be a sensible investment approach for us and we have been very successful (by our standards) first in direct investment and then by funding developers through our bridging and development lending platform, Avamore Capital.

When we started, we had remarkable ability to secure properties. Why? Was it because we were prepared to pay more for them? Occasionally but the situations were always competitive to a degree in relatively narrow markets. The primary reason was because we approached the agents and vendors with a degree of humility. We had to prove ourselves to them and thus made the effort on a personal level to put ourselves at the front of the queue, by being respectful, polite and acknowledging that when the difference in bid between us and the other top bidders was negligible, the agent had the power to decide who would win the day. In fact, we won more than one bid when not the top bidder because we had built a strong relationship with the agent and earned the right to be put forward as the recommended purchaser, even if we had offered slightly less. By earning our stripes, it gave us opportunities and lead to us purchasing fantastic development opportunities "off market" which we did very well from.

However, we did not carry this momentum on after the first 24 months. As we broadened our reach geographically, we made less effort to build relationships with key decision makers, particularly the agents. We made "safe" (sometimes cheeky) offers on properties that were wide of the mark and occasionally below asking price. We did not deserve special treatment. There was nothing special about us to merit preferential treatment. And it was only when we recognised that we had lost our humility did we start to be more successful in purchasing properties, resulting in recent exits delivering an average IRR of in excess of 40%.

I could even go back to 2009 when I worked for a PE real estate firm. In the depths of the recession, with some absolute jewels available at bargain basement prices, I naively and arrogantly thought I could get them for a further 10% discount and had an attitude to asset managers, agents and brokers that bordered on disrespectful at times. Shame on me really, as I think back to a world of missed opportunity on what might have been had I/we had a better approach to these professionals.

More recently, since we set up Avamore Capital with another SFO, I have seen humility come into play yet again as an important feature. Brokers that represent borrowers are highly powerful in the bridge lending market. So the first few months after establishing the platform were a bit of a wake-up call. It may have been contrary to my belief system that these people could take such proportionally huge amounts of risk-free economics from deals, but here's the thing: they had the control. They had the leverage. And we weren't special because we had plenty of competition for the deal. If you want to play poker, you pay the buy-in. So after an attitude adjustment we started to see a lot more deal flow and closed a lot more transactions too (and continue to do so).

So why am I saying this to you, my colleagues in the family office community? It is because I still see (and hear about from advisers) so much entitlement from SFOs. In a world which is ultimately oversupplied with liquidity, cash-rich family offices are effectively suppliers of a

commodity for which there is an over-supply. We are not deserving of special treatment from investment managers or brokers simply on account of the fact that we "have money". We have to earn it.

In particular, many first generation SFOs are often the most guilty of excessive arrogance. The tactics and behaviours that generated the Patron's wealth in the first place may have been effective in growing a successful business. However, in the current investment environment they are counter-productive. These SFOs can sometimes set unrealistically high return requirements for their internal teams for the products in which they invest, whilst at the same time demand better quality risks than the market. This means that less money gets deployed and the net returns to those SFOs are ultimately reduced. And on the rare occasions where they are making investments, their tight returns requirements results in their fighting with investment managers over economics.

If I was to make 5 recommendations to SFOs to help them be more effective in securing deals (and with respect this approach is not really limited to SFO), they would be:

1. Be polite and respectful to everyone
2. Be very clear with your criteria and do not deviate from your criteria. If you tell an investment adviser that you are interested in a particular field, then reject an opportunity when it is presented, then that is going to be problematic. Do not set your investment policy on whatever mood the investment committee is in on a given day.
3. Be responsive and in particular say no quickly. We have worked in the past with one SFO who never says no, just says yes very slowly. This is not the way to get ahead.
4. Perform. Do not agree to a deal and then "flake" out through lost appetite. Naturally, due diligence can drag up issues and if you cannot perform due to a due diligence matter, be open and up front about the issues. Capital preservation is most important and if a deal is not right, do not be pressured by an investment manager to do the deal, but your method of delivering the message is important.
5. Pay your managers and introducers. They aren't charities and it goes without saying that the better you pay, the better you'll get in terms of deal flow and quality. And, If you feel their required economics are too high, agree that before you commit to a deal, rather than put a gun to their heads 5 minutes before closing the transaction.

Family offices do so much good through philanthropic works and by supporting special causes in the Arts and in the Charity sector. Our community must therefore continue to prosper. However, it is important that SFOs raise their game and put themselves at the front of the queue again for the best deals. Attitude and behaviour, rather than capital are the key differentiating commodities in 2017. In the years to come, the balance of power may swing back to those with capital, but for now, SFOs should dial up the humility or risk underperforming.

About Avamore Capital:

Avamore Capital is a special situations lender that provides loans to property traders, property developers, property investors, and other property entrepreneurs. Loan sizes are between £0.5m and

£5m with larger loans possible in conjunction with its partners. Avamore Capital provides a flexible approach, quick feedback and very fast drawdown, subject to due diligence.

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