

California Family Offices

A Primer on Family Offices in the Golden State



Brought to you by the

Family Offices Group

Introduction

California is the largest state in America with 12 million more people than the second most populated state. California is also one of the biggest hubs for family offices as it is home to a high number of wealthy families and ultra-high-net-worth individuals. More generally, the United States currently has the largest economy in the world. In terms of GDP purchasing power parity, as of 2013, the United States ranks number one with \$16.72 trillion.¹ The U.S. has long been known as a business and financial capital. However, the United States was hit perhaps the hardest by the financial crisis and is still struggling to recover.

California has long been regarded as the west coast's capital of wealth and business activity. The state's beautiful coasts, celebrity residents, and international appeal have made it a hub for businesses and individuals for decades. Led by Los Angeles and San Francisco, California claims a high number of ultra-wealthy families and, with the recent series of acquisitions and IPOs of California-based companies, that number is growing still.

While it might be tempting to associate California's family office community exclusively with its film and television stars, athletes and similar high-earning celebrities, the truth is that many of the family offices were started by families with more traditional business backgrounds in industrials, real estate, business services, and other non-entertainment-related areas. Given how much economic activity occurs in California, it is no surprise that many of the businesses founded and operated in the state have made many individuals and families exceedingly wealthy. Los Angeles is home to the massive entertainment industry but it also operates one of the busiest ports in the world, occupies a major financial nexus for international investing and banking, and inspires many famous entrepreneurs in fashion, electronics and computers, and a multitude of industries that rely on the location to headquarter operations.²

Fifty-three companies on the Fortune 500 hail from California and, while there are several high-profile technology firms like those mentioned above, the industries in which these companies have excelled vary. There are financial services firms on the Fortune list like Wells Fargo, Visa, and Charles Schwab, healthcare-focused companies (Health Net, McKesson, Molina Healthcare), energy giants like PG&E and Chevron, and more companies operating in industries outside of technology like Walt Disney and Gap.³ The number of large companies based in California, and those local firms that seek to challenge today's leaders for top position, shows how competitive and active the California business scene is in 2014 and will likely continue for decades to come. This is great for the economy but also

¹ <https://www.cia.gov/library/publications/the-world-factbook/rankorder/2001rank.html>

² <http://www.city-data.com/us-cities/The-West/Los-Angeles-Economy.html>

³ <http://money.cnn.com/magazines/fortune/fortune500/2012/states/CA.html>

for family offices hoping to serve these wealthy clients and those who would like to partner with or raise capital from local family offices.

The boom in technology and internet-based companies created a new generation of affluent Californians and there are many business founders and investors who have amassed billion dollar fortunes thanks to this growing industry, such as Facebook's Mark Zuckerberg, the Google founders Page and Brin, and recent Forbes List addition Jan Koum (WhatsApp). Unlike the dot-com-era start-ups that amassed huge amounts of wealth thanks to excessive valuations, today's technology millionaires and billionaires founded and manage companies that produce impressive revenues and stand little chance of seeing their value erased overnight.

Family Offices in California

Although the highest proportion of family offices in the U.S. resides in New York, there are nearly as many operating in California. In the Family Office Database Version 9.0, California represented the largest portion of the western half of the United States and was second only to New York in state ranking by number of resident family offices.

According to Bloomberg's ranking of the Top 50 Family Offices⁴, three of the top fifty on the list are based in San Francisco (Baker Street Advisors, Presidio Group, and Ascent Private Capital Management) and Harris myCFO is based in Palo Alto, CA. Furthermore, many large multi-family offices have at least a western regional office, if not a large office location in California. There is a strong family office hub in California and it is rare for any large multi-family office to not have any clients in the state.

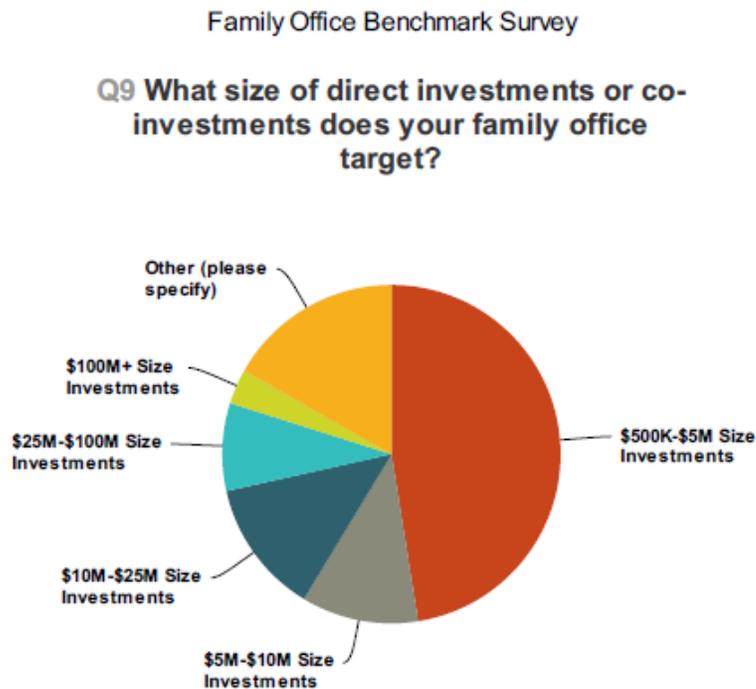
Beyond multi-family offices, there are many single family offices and ultra-wealthy individuals based in California. The range of wealthy locals is wide, including such industry titans as Larry Ellison, who has a home in Woodside, CA valued at more than \$70 million—a fitting estate for the Oracle founder, who is worth an estimated \$43 billion. On the lower end of the ultra-wealthy spectrum are many newly-wealthy individuals, most of whom became centimillionaires or billionaires through an initial public offering, sale to a larger corporation, or rapid growth of their business. Sheryl Sandberg became a billionaire after joining Facebook from Google and helping Facebook navigate its IPO, which gave her and other insiders an avenue to sell shares, should they choose to do so. This is a common story, especially in Palo Alto and San Francisco, where companies from Twitter to eBay have churned out wealthy founding members, partners, and executives.

Family Office Benchmarking Survey: California Results

⁴Among other resources, Bloomberg relies on our family office database at www.FamilyOffices.com to help track the top family offices included in their Top 50 Family Offices ranking.

We recently conducted our first annual Family Office Benchmarking Survey and several of the nearly 200 respondents were from California. From this segment of the survey group, the family offices located in the Golden State all reported targeting direct investments and co-investments in the \$500,000 - \$5 million range in line with the most common answer in our complete survey (please see the chart in Figure 1.1 below, which shows our full survey response). The California-based family offices also stated a preference for minority investments, preferring to invest alongside an established co-investment partner or otherwise limit their exposure to any one particular deal. The fact that none of these family offices reported targeting direct or co-investments above \$5 million is also telling, as these California family offices unanimously prefer to make minority and small-to-middle-market deals, rather than executing some of the large deals that have been done by family offices and co-investment groups in recent years.

Figure 1.1



As you can see in Figure 1.1, the Family Office Benchmark Survey responses varied more than the California family office segment in the size of these investments but the majority was in line with the California group.

Although the data from our survey shows that California family offices prefer a less active, majority interest in their deals, The Family Offices Group expects that these family offices and others who are wading into co-investments and direct investments in operating businesses will expand their investment activities and become more active investors in the future. As these family offices improve their deal capabilities, hire more seasoned investment professionals, and gain experience executing smaller investments, it is expected that they gradually will join the family

offices and institutional investors that are taking majority stakes in companies and investments and targeting larger deals.

Another interesting finding in our Family Office Benchmarking Survey is the composition of the portfolio managed by the representative California single and multi-family offices. The respondents all reported dedicating a portion of the portfolio to so-called traditional investments (long-only, stocks, ETFs, mutual funds) with 20% being the lowest percentage of the portfolio and one respondent reporting that 100% of the family office's investment portfolio was in these traditional assets. The majority of the California family offices reported having at least some exposure to alternatives (hedge funds and private equity) but these investments never surpassed 20% of the portfolio, in line with what most family offices allocate to alternative funds. Allocations to direct investments was an equally sizable portion of most California family office portfolios reported in the survey, with one family office in particular reporting that 60% of the portfolio is dedicated to direct investments. Real estate and hard assets rounded out the portfolio for these family offices. As Californian investors know, real estate is typically a large part of the portfolio for high-net-worth and ultra-high-net-worth families. A family office noted that 70% of its portfolio was dedicated to real estate and hard assets. While there has been a noticeable shift among family offices toward real estate following the bubble—as many took advantage of the troubled real estate market post-crash and scooped up valuable assets at a discount to pre-recession valuations—this allocation is still remarkable and outside the typical family portfolio composition reported in our survey.

How California Family Offices Contrast with Other City and Regional Hubs

As anyone who has worked in the family office industry knows, family offices vary in structure, size, services, and other ways depending on where the office is located. For example, in New York, the family office community is very mature with regular meetings and events, frequent co-investing and joint ventures between family offices, and established, efficient offices, primarily in Manhattan. In other parts of the United States and certainly abroad, family offices are more diverse. California family offices are typically sophisticated in their operations and structure but many single family offices are more private than you might find in New York. Manhattan-based family offices typically are more active in the investment and financial community and participate frequently in industry events and networking opportunities. Moreover, these family offices often have a more active, engaged investment team and spend more time listening to presentations from investment firms and potential deal partners than you'd find out west. One reason is simply travel and logistics; it is easier for investment firms (most of which have at least a branch office in New York) to trek up to midtown and even line up multiple family office meetings for the week, than it would be to fly or drive around California to the less geographically concentrated family offices there.

Like New York, there is a strong concentration high-net-worth individuals in the major Californian cities and it can be difficult to determine whether the family office you are meeting with is, in fact, a family office with considerable wealth (\$100m+) or simply an advisor to a high-net-worth family (sub-\$100m). A common frustration shared by both family offices and those hoping to work with family offices is the experience of a person misrepresenting themselves as a family office or ultra-high-net-worth individual only to find that the person is either exaggerating or simply misunderstanding the distinction between a single family office and an upper-class family.

In smaller cities it is often easier to recognize the true single family offices and ultra-affluent families; for example, everyone inside and outside of Wichita knows of the Koch family and its multi-billion-dollar fortune. In a smaller pond, it's easier to see the big fish, but in the ocean of California, it can be tough to determine who the truly wealthy and active family offices are and how you can connect with them. Our team was recently contacted by a large California-based single family office executive who expressed frustration by the lack of a formal community in California and the west coast, compared to New York and even the smaller hubs like Miami and Chicago. We have reported the co-investing trend that is particularly strong among family offices and for single family offices like the one just mentioned, it is tough to build a strong co-investment network or syndicate with other single family offices when the family office community is so geographically and organizationally fragmented in California.

Geographical Fragmentation

Another difference between California family offices and other wealth hubs like London, New York, Singapore, etc. is that the industry in California is highly fragmented geographically. For example, an ultra-high-net-worth individual may have a family office headquartered in La Jolla (a suburb of San Diego) or Palo Alto (near the San Francisco Bay Area) or clear out in Pasadena. In London or Singapore, most of the family offices are based in the same area, even the same neighborhood, making for a greater sense of community among family offices than you might find in a larger state like California with its multiple large cities (Sacramento, Los Angeles, San Diego, San Francisco, and San Jose).

There are also a number of wealthy investors like Tom Perkins, John Doerr, and Peter Thiel, Californian venture capitalists who became billionaires by backing start-ups and growing businesses. Among the single family offices in California, there is a strong appetite for risk, with many families led by part-time angel investors or venture capitalists or wealthy business executives who are comfortable allocating to new technologies and disruptive companies. This is one of the key differences in how many California-based family offices invest compared to their peers around the world. In different geographical locations, most family offices prefer to limit their angel and venture capital investments to those businesses with which they have a personal connection or past experience working with the firm.

Beyond these infrequent investments, many family offices seek more established businesses with stable revenues and more moderate risk than the startups and emerging companies that VC's and angels back. In California though, the proximity to Silicon Valley and the highly active startup scene has made many local family offices willing to make early stage investments.

The Disadvantages for California-Based Family Offices

The most obvious disadvantage for family offices headquartered in California is the onerous tax environment there. California is just now starting to recover from a massive budget deficit that forced new taxes, tax increases, and austerity measures to make up the shortfall and prevent a statewide government collapse. Furthermore, cities from San Diego to Los Angeles struggled to maintain basic services for citizens amid the challenging economic and fiscal environment. But the tax environment in California has long been higher than many other states and the recent economic events have merely reinforced and escalated that reality for wealthy residents. Many families relocate to more moderate tax environments or work with the family office team and outside advisors to structure their wealth management in the most tax efficient manner possible and may spend more of their time in a different city or state than the one they had resided in prior to their financial windfall.

Why California?

The Family Offices Group is hosting four family office conferences this year and two of these events are based in California. With so much family office activity in New York and Miami and the preceding paragraph listing some disadvantages to the state, it begs the question: why California? Hopefully this white paper on California Family Offices has demonstrated the high concentration of wealth in California, spread among many major cities including San Francisco, San Diego, Los Angeles, and more metropolitan areas nearby. The U.S. economic recovery and the California state recovery from a near catastrophic fiscal crisis, has led to greater business development and expansion in California and increased the wealth of many residents. The recovery in the state has also eliminated some of the fears of even higher taxation and poor business conditions for local businesses and the families that own and operate them. Many local families are now returning with interest to the prospect of setting up their own single family office or otherwise more proactively managing and organizing their family wealth and assets.

For those already established family offices in California, there is a pervasive desire to expand their investment teams, engage in more aggressive and involved deals either directly or through co-investments, and to work with local family office peers to improve operations and capabilities. In our Benchmarking Survey's California family office segment, the most common desire in connecting with other family offices was for the purpose of sharing best practices. This belies a common need for family offices in California: to network and share resources and

experiences with other family offices. That is why we are hosting our Los Angeles Family Office CIO Summit on June 6th and why we will visit San Francisco for a Direct Investment and Co-Investing Conference on September 26th, because these gatherings present local family offices with an opportunity to learn from other family offices and improve their operations in a way that is not otherwise possible outside of these meetings.

California remains an important hub for family offices and that is unlikely to change, although family offices will continue to explore more tax- and politically-friendly locations in the U.S. and abroad. Californians drive the American economy and the new wealth generators in the state will form new family offices to manage and protect that wealth. That is why the Family Offices Group and our Single Family Office Syndicate remain committed to the local family office community in California and look forward to hosting events there, like the June 6th Family Office CIO Summit and the September 26th Co-Investing and Direct Investment Summit in San Francisco.

If you would like to discuss the California family office marketplace or learn more about the Family Offices Group please email our team at Team@FamilyOffices.com or visit <http://FamilyOfficesGroup.com>. You can also find more information on how we work with single family offices directly at <http://SingleFamilyOffices.com>.



Richard C. Wilson

Founder & CEO

Family Offices Group

www.SingleFamilyOffices.com

www.FamilyOfficesGroup.com