FORGE COMMUNITY

BENCHMARKING SURVEY REPORT

Costs of running a family office

About the survey

The costs of running a family office have always been hard to understand and define. This report on the cost of running a single family office is a valuable tool to help define and plan for expenses across a variety of entity types and structures.

Led by The Forge Community, with assistance from Deloitte, the *2020 Benchmarking Survey on the Costs of The Single Family Office* focused on understanding expenses for five family office operating structure types:

- Investment office
- Shareholder office
- Founder office
- Compliance office
- Trustee and philanthropic office

Participation was by invitation only, and respondents included 187 single family offices (SFOs). Data is presented for six median categories of assets under management (AUM):

- More than $5 billion
- More than $1 billion to $5 billion
- More than $750 million to $1 billion
- More than $500 million to $750 million
- More than $250 million to $500 million
- $250 million or less

Key takeaways

From the Forge Community survey of 187 family offices who participated in the Fall of 2020.

- There is wide variation in the expenses of family offices; it is not unusual to see what appears on the surface to be offices of similar size having a 30% difference in the ratio of total expenses to AUM.
- There are economies of scale of AUM in operating family offices, likely due to many functions in the family office being leverageable, such as asset management. On the smaller end of the size range economies of scale are less apparent, perhaps due to the increase of the scope of services as offices grow toward the $500 million AUM level. The maximum and median budget levels in dollar terms are virtually identical for the $625 and $875 million AUM tranches of family offices.
- The budget allocation into expense categories for family offices does not change significantly between offices of differing size as measured by AUM.
- Investment offices and offices that serve as fund managers, which often overlap, tend to have significantly higher expense ratios than offices of similar size that do not classify themselves that way.
- The overall average cost ratio for the 187 family offices in the survey is 0.41% of AUM, but averages don't tell the whole story.

Family offices are complex businesses that serve a wide variety of families with diverse needs and philosophies. It is no surprise that when surveying family offices to benchmark costs, a complex picture emerges that has several cost drivers. AUM is both a driver of cost and a source for economies of scale, but there is much more to the family office cost equation than AUM alone. A common way to compare family office costs is total expenses divided by AUM. The 187 firms in our sample had an average cost of 41 basis points (bps) (0.41%) of AUM. However, since there are multiple drivers of cost among this diverse group of firms, averages don't tell the whole story.

We will dive deeper into the family office cost story with a look at: cost by AUM tranche, cost by family office type, how the number of generations served impacts cost, and the total budgets by AUM and the allocation of those budget items.

We will also dig into the expense philosophy, which has turned out to be an important factor related to total expenses and expense allocation among the survey respondents.

MEDIAN FAMILY OFFICE
Serves 3 generations
Has 6 employees
Serves 10 family members
Serves 20 legal entities
$625M in AUM
$2,000,000 annual operating budget
Expense ratio of 30 bps (0.30%)

AUM relationship to cost

We collected detailed budget data as well as AUM data within ranges. Let's look at the data in absolute terms by AUM tranche and represented as the family office budget divided by AUM.

Figure 1. The maximum and median budget amount for each AUM tranche

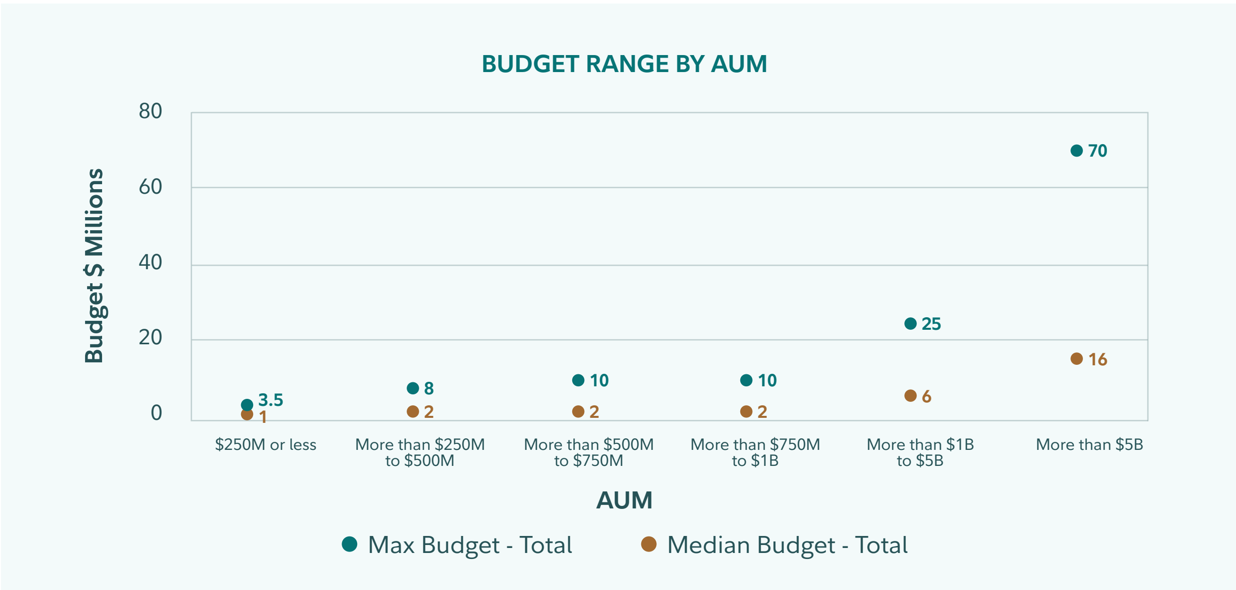
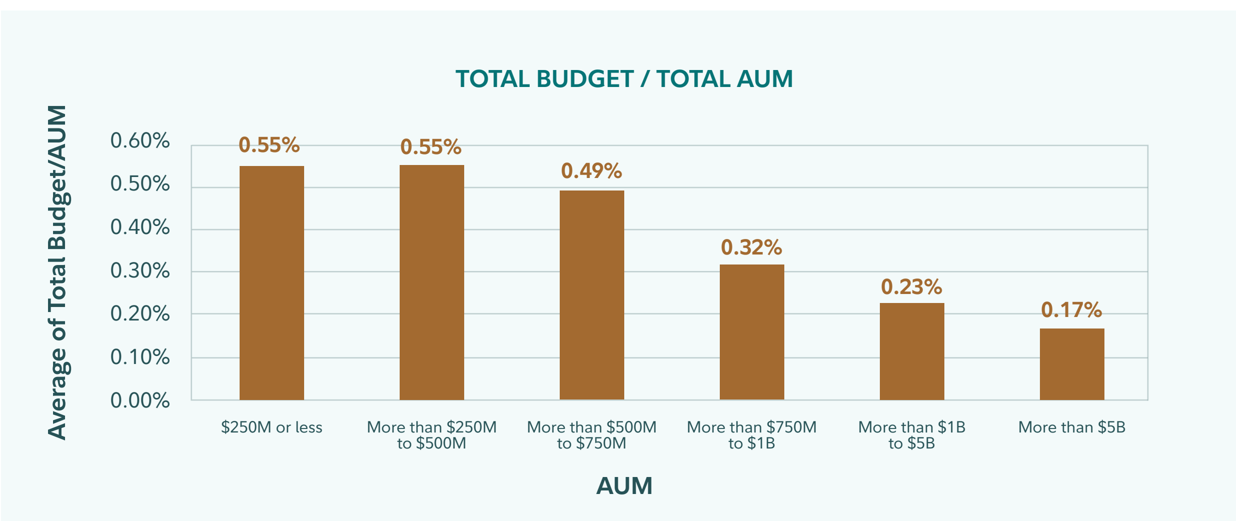


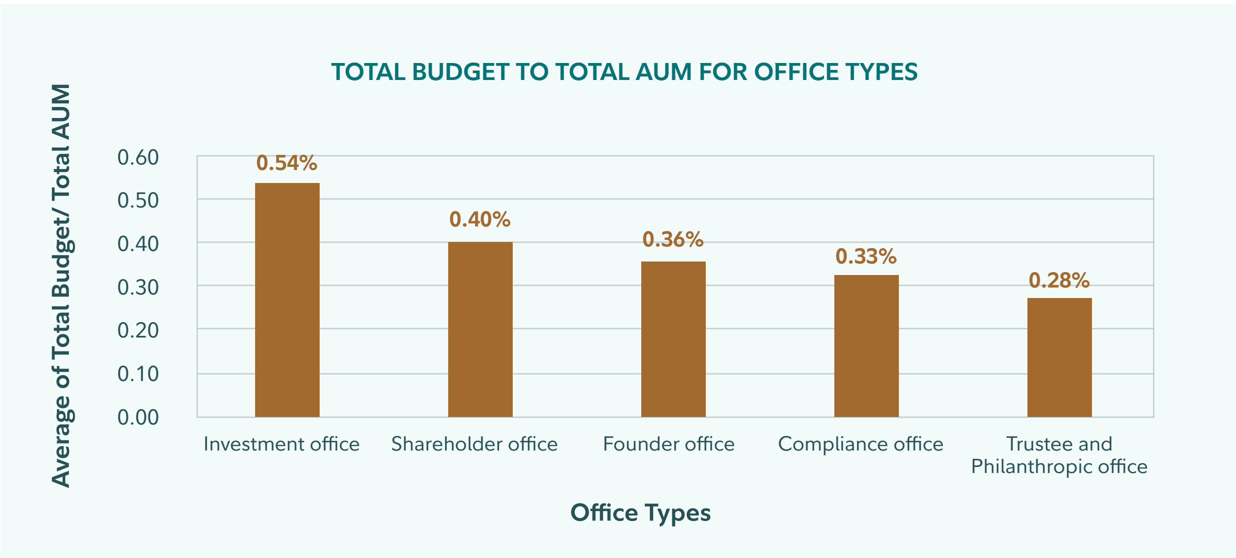
Figure 2. Family offices show economies of scale as AUM increases



The linear relationship between total budget and AUM indicates that there is a correlation between budget and AUM. The wide and widening range between the median and maximum budgets indicates that other factors are contributing to the size of the family office budget. We can also see economies of scale based on AUM. The smallest family offices, averaging approximately $200 million in AUM, are operating at an average cost of 55 bps of AUM, and the largest, with an estimated average of $12.5 billion in AUM, are operating at 17 bps. These numbers represent averages within the AUM tranches. Since considerable variability is present in the expense ratios for each tranche, AUM is far from explaining all of the variation in cost. As you compare individual family offices to these benchmark values, the differences may be related to efficiency or they could also be based on the tasks performed, the operating philosophy of the family office, or the complexity of the family being served. AUM is just the first, and most logical benchmarking consideration.

Family office types are fairly straightforward way to capture the priority of the family office, and by extension, the tasks performed by the family office. In our survey, the respondents were asked to self-classify into just one of the family office types often used by family offices and the articles about them. Respondents were given some guidance on these definitions, which you can find in the appendix of this report.

Figure 3. Investment offices operate at an elevated expense ratio



Investment family offices are more expensive to run as a percentage of AUM than other family office types. This increased expense is independent of AUM size. Investment offices are not concentrated in the smaller AUM tranches, which might indicate that investment offices could be coincidentally more expensive to operate – however, this is not the case. Investment offices simply reported higher budgets that are not explained by other factors. As firms consider insourcing versus outsourcing investment management key questions to consider are:

- What types of mandates make the most sense for the asset allocation and investment philosophy?
- Does the family office have the appetite to stand up a sophisticated active management capability?

Investment operations drive cost into the family office budget, but likely drive down total cost of management of the investment portfolio, which is often netted into investment performance with the use of outside investment managers. This significant portion of the family office cost equation calls for thoughtful management, as the cost associated with investment management is tied to a strategic decision and commitment for the family office. The results of benchmarking the investment cost are but one factor in the decision to run active management within the family office.

Another factor to note when benchmarking investment operation is the level of outsourcing. Investment offices did often in-source all of the investment operations, but the average level of insourcing of investment decision making by survey respondents is 67%. Interestingly, shareholder offices in-source 50% of their investment decision processes, and there are also multiple shareholder offices that in-source all of the investment decisions. Investment operations are far from an all-or-none decision.

Office philosophy as a cost driver

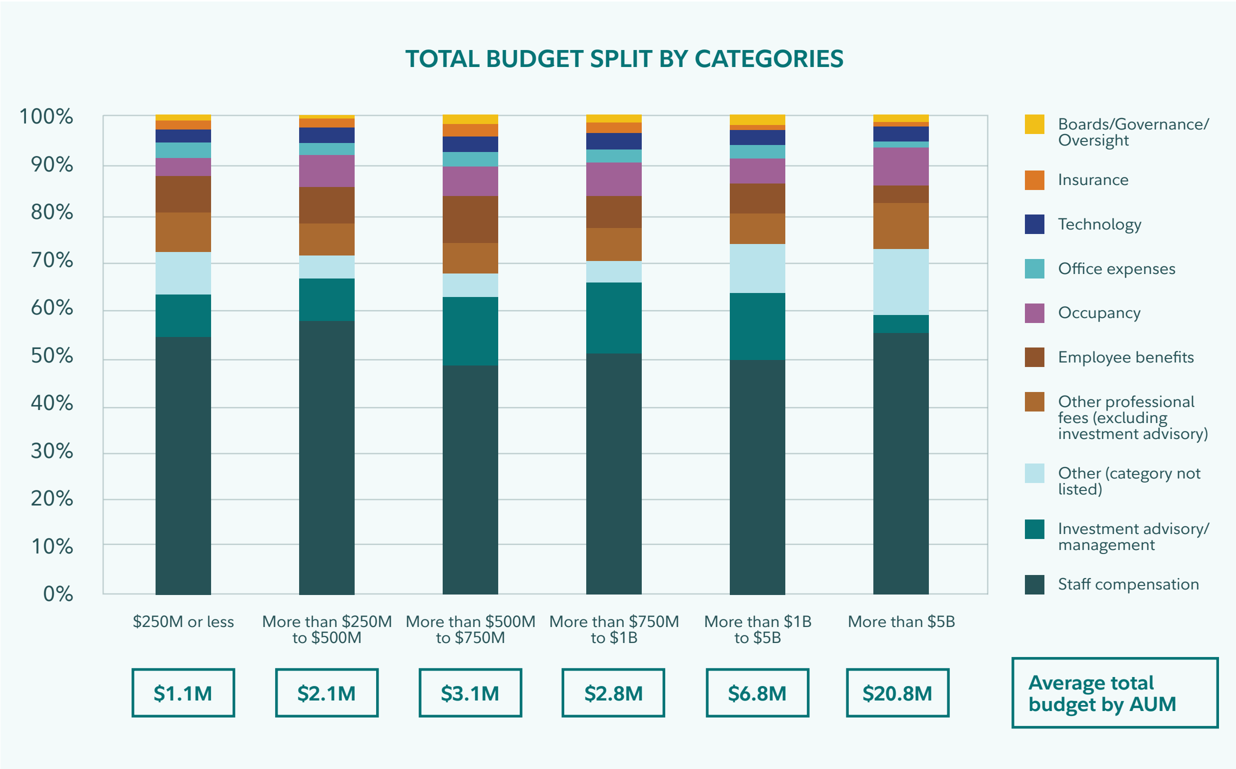
Some family offices have been organized to assume investment expenses in the family offices legal entity as opposed to other entities, particularly if the family office serves as a fund manager. When a family office operates with this philosophy it adds about 20 bps to the operating expense to AUM calculation. These firms also tend to self-identify as investment offices at a greater than average rate. So, while these firms operate at higher expense ratios, they also notably perform more expense heavy tasks within the family office. These operating choices are in-line with the strategy. Since these are related attributes, we can't distinguish between the impact of either one individually at this sample size.

Another potential philosophical cost driver is the decision to offer incentive compensation. This driver is a little easier to understand. Firms that offer incentive compensation operate, on average, at 10 bps higher expense ratios. But interestingly, for investment type family offices, offering incentive compensation has only a negligible impact on the cost ratios. In future surveys, more about incentive compensation could be learned.

Other business metrics' relationship to cost and action steps

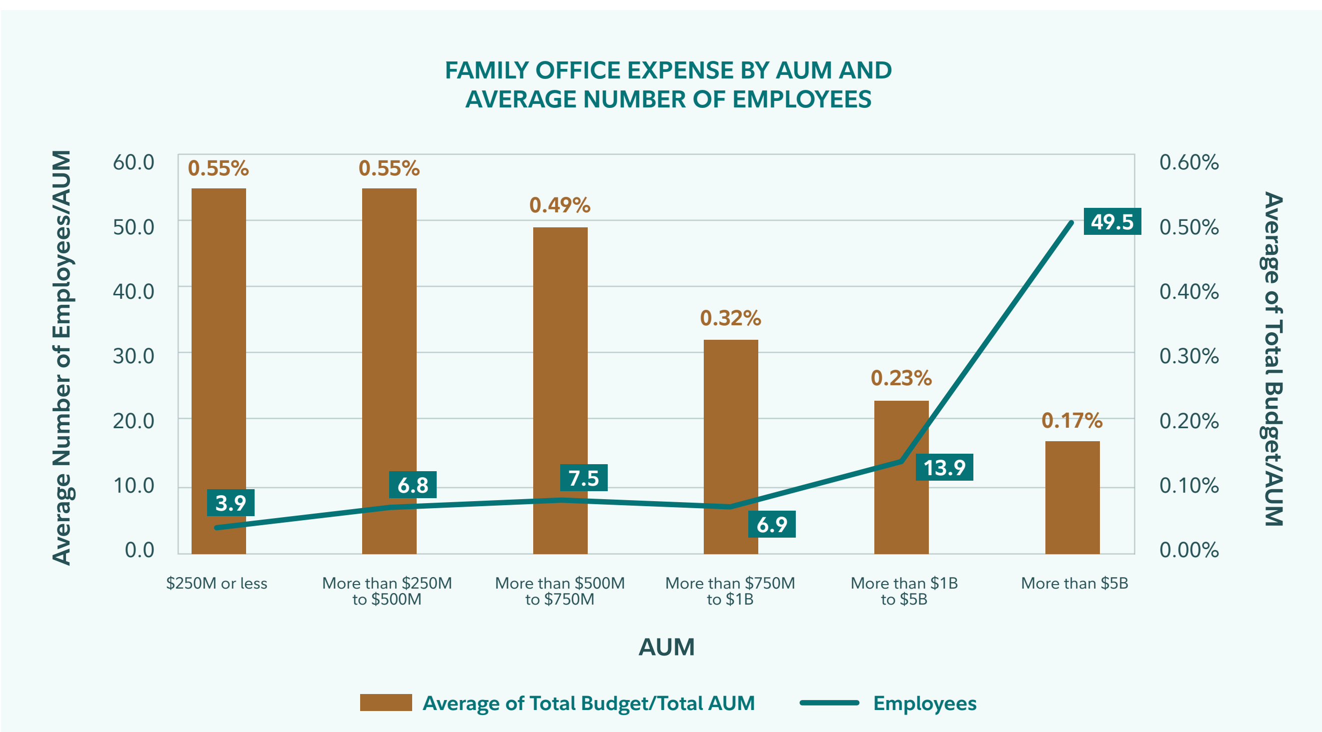
As we dive into the breakdown of family office costs and other business metrics that are related to family office expense ratio it becomes very clear that employee costs account for roughly 60% of family office expenses across all size groups. It appears that the cost breakdown is relatively constant across the AUM tranches for family offices. There is only one anomaly in the cost breakdowns, the drop in investment management costs on both a percentage basis and a dollar basis between family offices of $1-5 billion AUM to over $5 billion. This drop is likely due to a combination of interpreting the question differently, a difference of investment expenses being accounted for as direct expenses (in the budget), and investment management expenses netted out of investment returns. The survey results indicate that economies of scale accrue as AUM increases. How does that happen if the breakdown of costs is constant? Most of the expenses are either staff compensation directly or correlated to staff compensation, such as occupancy, office expenses, and employee benefits. These three items together account for roughly 70% of the budget across the AUM tranches.

Figure 4. Expense breakdown holds relatively constant across AUM tranches



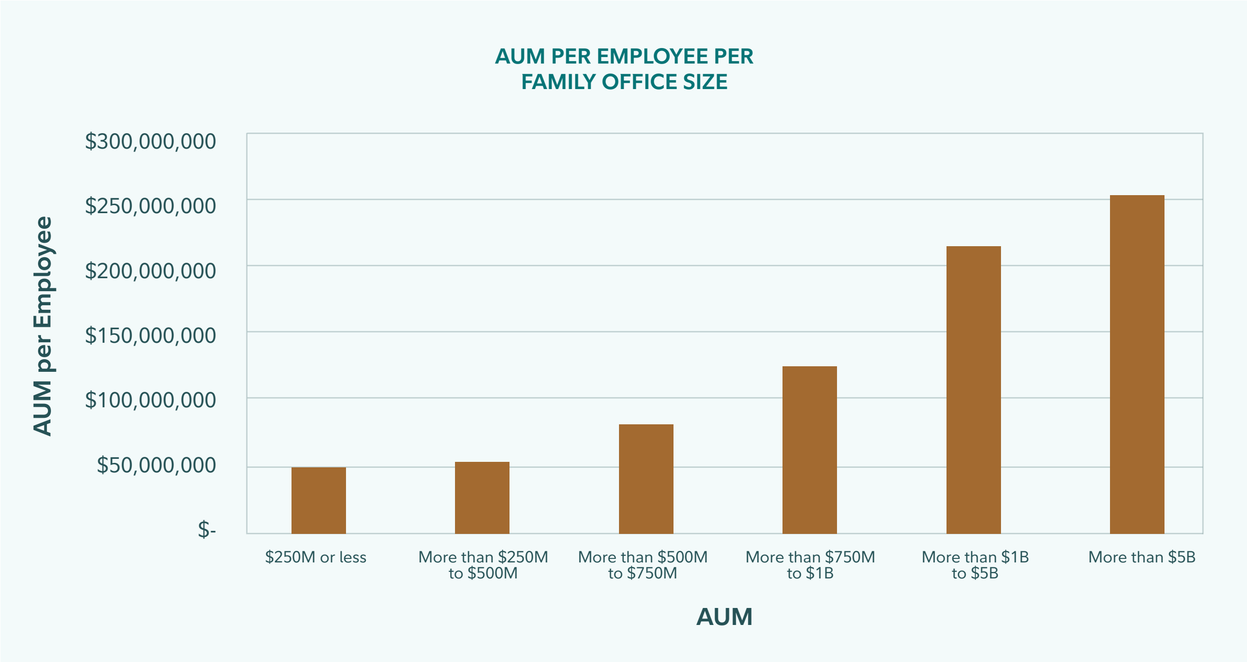
Perhaps operations in a family office can offer just so many services, and after a point, adding more AUM stops adding to the types of tasks performed in a meaningful way, and economies of scale accrue.

Figure 5. AUM increases more rapidly than the number of employees of family offices



In studying the AUM per employee in family offices, it shows that for the two smaller AUM groups of family offices, the average number of employees is 3.8 for the offices with an average size of $200 million AUM and 6.8 employees for the offices that average $375 million in AUM. That is about $50 million AUM per employee in each case.

Figure 6. AUM per employee rises dramatically with AUM



However, as offices get larger, the AUM per employee increases sharply, crossing over $200 million per employee as the average family office AUM reaches $3 billion. Unfortunately, there are few options to take advantage of this economy of scale. A four-employee family office can't let two employees go, or double its AUM overnight, to improve the AUM per employee.

While this knowledge is valuable for benchmarking purposes, be sure to consider all the complications and services offered in a family office before comparing the AUM per employee to peers, because there is significant variation of budgets in dollar terms, as shown in figure 1. The average family office is a good benchmark for expense ratios when considering the uniqueness of the family office being compared, and the average breakdown of expenses.

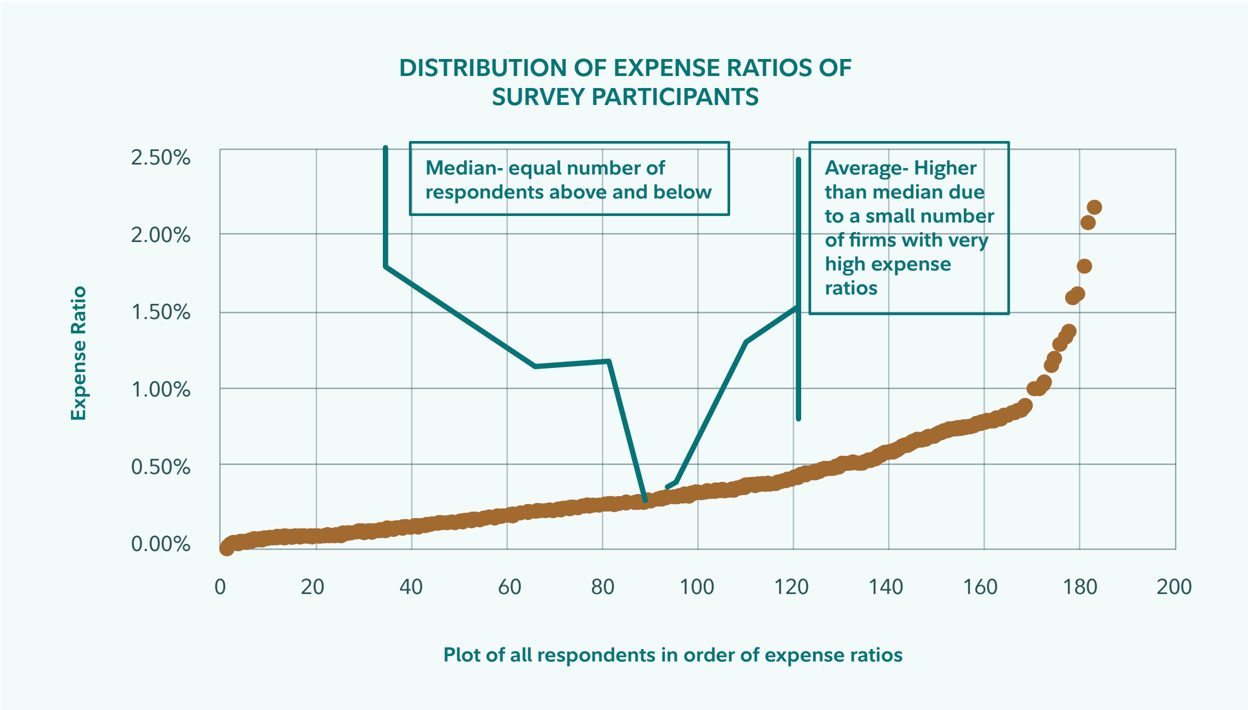
Want to play with the numbers yourself? Forge Community members participating within the Forge platform will be offered exclusive access to an interactive benchmarking tool in the late summer of 2021.

Methodology

The Forge Community Research Committee, assisted by Deloitte, crafted a short, 15-question survey and put the survey in field in the fall of 2020. The survey participants were all single family offices, and many were members of The Forge Community. 187 single family offices completed the survey. The respondents were asked to both select their range of AUM and enter their AUM. With both points of data submitted, the average AUM based on actuals submitted were calculated and used for the purposes of this report.

Significant effort was made to ensure that all survey responses were anonymous from end to end. No identifying information was captured from survey respondents. Using data visualization and discussion with the Forge Research Committee, the final report was drafted based on the findings and factors uncovered by both efforts. The results of this survey may not be representative of all family offices meeting the same criteria as those surveyed for this study.

Graphical representation of survey participants



Respondent count by number of employees

Number of employees	Number
1 to 2	28
3 to 4	40
5 to 7	45
8 to 12	38
>12	36
Grand total	**187**

Respondent count by AUM

AUM	Number
$250 million or less	40
More than $250 million to $500 million	48
More than $500 million to $750 million	21
More than $750 million to $1 billion	18
More than $1 billion to $5 billion	46
More than $5 billion	13
(blank)	1
Grand total	**187**

Respondent count by family office entity type

Family office entity type	Number
Partnership (includes LLC taxed as a partnership)	59
C-Corporation (includes LLC that "checked the box" to be taxed as a C-corporation)	50
Disregarded entity (e.g., Sole proprietorship or single member LLC)	36
S-corporation (includes LLC that has made an S-election)	26
Not applicable – imbedded in business operating entity	14
Other	1
No reponse	1
Grand total	**187**

Respondent count by family entities served

Family entities served	Number
1 to 5	37
6 to 12	38
13 to 25	40
26 to 60	37
>60	35
Grand total	**187**

Respondent count by family members served

Family members served	Number
1 to 4	39
5 to 7	39
8 to 12	34
13 to 25	40
>25	35
Grand total	**187**

Respondent count by generations served

Generations served	Number
1	20
2	61
3	77
4 or more	29
Grand total	**187**

Respondent count by operating philosophy

Operating philosophy	Number
Breakeven or near break-even (i.e., fees charged or reimbursements made to cover costs annually)	89
Runs at an operating loss (operating deficits subsidized by owner contributions)	47
Serves as a fund manager(i.e., family office funded predominately through partnership profits allocations)	30
Runs at an operating profit (i.e., fees charged generally exceed operating costs)	16
Other	5
Grand total	**187**

Respondent count by region

Region	Number
Central/Midwest (IA, IL, IN, KS, MI, MN, MO, ND, NE, OH, SD, WI)	46
Northeast (CT, DC, DE, MA, MD, ME, NH, NY, PA, NJ, RI, VT)	46
Southwest (AZ, NM, OK, TX)	33
Southeast (AL, AR, FL, GA, KY, LA, MS, NC, SC, TN, VA, WV)	29
West Coast (CA, HI, OR, WA)	21
Mountain/West (AK, CO, ID, MT, NV, UT, WY)	12
Grand total	**187**

ASSET ALLOCATION OF SURVEYED FAMILY OFFICES

All family offices excluding 5 billion and above

Asset Allocation Categories	Avg. Input Asset Allocation
Marketable Securities	26.9%
Private/Closely Held Business	11.6%
Fixed Income	10.2%
Real Estate – Directly Owned	9.6%
Private Equity & Venture Capital – funds	8.8%
Cash & Cash Equivalents	8.6%
Hedge Funds	8.2%
Private Equity & Venture Capital – direct	6.7%
Real Estate - Funds	2.7%
Commodities	1.3%
Collections (Art, Collectibles, Etc.)	1.2%

Family offices 5 billion in AUM and above

Asset Allocation Categories	Avg. Input Asset Allocation
Marketable Securities	29.6%
Fixed Income	29.6%
Other	16.6%
Private/Closely Held Business	11.9%
Hedge Funds	10.8%
Private Equity & Venture Capital – direct	10.5%
Private Equity & Venture Capital – funds	9.4%
Cash & Cash Equivalents	3.2%
Real Estate – Directly Owned	2.6%
Real Estate - Funds	1.5%
Collections (Art, Collectibles, Etc.)	0.1%
Commodities	0.0%

GLOSSARY

Survey definitions

- **Founder office** – supports the activities of the business founder/first generation
- **Shareholder office** – supports the activities of a business owning family
- **Investment office** – supports family clients on public and private equity investing
- **Compliance office** – supports family clients on accounting, tax, and other financial services
- **Trustee office** – supports trustees and beneficiaries in a fiduciary capacity
- **Philanthropic office** – supports philanthropic endeavors of family members or family philanthropic entities (i.e., private foundation, supporting organization, etc.)

974714.1.0