Keynote Address by Managing Partner Bruce Stachenfeld at IMN's Borrower & Investor Forum on Real Estate Mezzanine Financing & Subordinated Debt

Has anyone here heard of Michael Porter? Michael Porter is a professor at Harvard Business School. He largely invented "competitive strategy" as a science. His books are worth reading.

One of the most powerful statements he makes in probably all of his books is that "strategy" is "deciding what **not** to do"!

Please keep that thought in the back of your mind for a few minutes and I will tie it into what I am speaking about, which is what I thought would be the most important thing for everyone in this room; namely, sourcing mezzanine loan transactions. And not just any transactions – transactions that are high-margin in nature.

Let me introduce myself? I am Bruce Stachenfeld. I am the managing partner of Duval & Stachenfeld. We are a 70 lawyer law firm in midtown Manhattan, which focuses on real estate.

I am going to reveal some personal stuff about myself and my firm here. I don't want this to sound like an advertisement for my firm – and I sincerely apologize for what I am about to say in that regard – but there are two things that I did that worked for me in formulating my firm's competitive strategy that I think might work well for mezzanine lenders – so explaining what I am about and what my firm is about is necessary.

At heart I am a plain old real estate lawyer. And I will admit – here in front of all of you – that something that is very important to me is obtaining clients for my firm. There are no two ways about it.

So there are two things I did. One was I narrowed the focus of what our firm was about and the other was I changed how I was marketing myself.

The first thing I did was to make our firm unlike our competition. Instead of trying to be a full-service law firm that is all things to all people, we focused our firm 100% around real estate. We now call ourselves The Pure Play in Real Estate Law. This means that our litigators focus on real estate litigation, our corporate lawyers focus on corporate real estate, our tax lawyers focus on real estate tax, etc. Our goal with this narrow focus is to obtain top status in our niche. We completely followed Mr. Porter here and decided what "not" to do in setting our strategy.

The second thing I did was I changed the way I did business. What I used to do was this:

I would call up someone and like all other lawyers say something like: “Hi my name is Bruce. You are a major player in the real estate world. My law firm is one of the largest and most prestigious real estate practices in New York City. I would like to meet with you to tell you why we would be an excellent choice for your legal work. Perhaps we could do lunch?”

Now the result of that kind of a statement is very simple for a lawyer. It earns the lawyer a very special place in the mind and heart of the recipient – it is a special “do not respond to” list, meaning that the counterparty should do everything in his power to avoid me, not for just a few weeks or months, but for the entire rest of his life.

Why this result? Simple – I was thinking about what “I” wanted and not what the other person wanted. He doesn’t want another lawyer around – he already has a lawyer, and there are plenty of lawyers all over the place. What he does want is introductions to counterparties, investors, deals, ideas to help his business grow, and things like that. I am selling one thing but he wants to buy another thing.

So I changed what I did and started thinking of what my clients wanted. I spent a ton of time and over five years doing this. What I did was I went out to just “meet” everyone I could. I didn’t say “meet me so I can sell to you”. Instead, I said “don’t worry I won’t try to sell legal services to you – there will be no pitching! Instead, I just want to find out what you are trying to do as I think you would be an excellent counterparty for my clients. Let’s get together and see what connections can come of it.”

Fast forward – I have become very useful – and many people now want to get to know me and meet with me. I make an uncountable number of connections for my clients. None of them are “brokered” – and all are based on things I have learned about the people I have met and who I think would work well with who else.

My law firm is now one of the largest real estate practices in New York City, but of course only in our narrow niche of real estate.

This is all because I did two things:

I narrowed my focus and made my strategy about “not” doing things outside real estate.

And I twisted the dial of how I did business – I looked at things from what my clients wanted instead of looking at things that I wanted.

So now – with one additional apology for what I hope didn't sound like a sales pitch for my firm – I am going to do my best to apply these principles to the mezzanine lending business.

Let me start by making things sound as bad as they could be and work back from that:

First, when you get down to the basics, the biggest issue is that money (the product being sold) is often thought of as a commodity. Therefore, as we remember from as far back as college, perfect competition will wipe out or reduce the lender's profits eventually

Second, the internet and the technological world are rapidly eroding the whole concept of "off-market" – so that everyone knows everything

Third, at present there is an awful lot of money around in this space – and even if there isn't for a short period of time, if there really is a need, then money will flow into this space promptly. Indeed, it is rare that a week goes by that I don't run into someone talking about starting a high-yield debt fund. Not to mention that many of the opportunity funds are either putting out mezzanine debt or developing mezzanine lending arms.

Ultimately, in a strong economic market the borrower has many options for purchasing money and therefore being able to drive the pricing of such money so low that the lender is not making sufficient profit from selling that money.

So that is the bad news – the enemy – now let's talk about an idea that could solve these problems…..

As an aside, I don't mean to imply that everyone in this room is having trouble finding deals. I am sure some players are very busy right now. However, anecdotally, I do see a fair number of my clients having trouble finding deals and/or having less pricing power than they would like. And I suspect that as the market and the economy gets stronger and more money flows into this space, this lack of pricing power will increase.

So the lender wants to provide money to the borrower – that is the lender's goal. However, the borrower's wants are not necessarily aligned with the lender's. Let's consider what the borrower wants. I bet he wants the following:

If he is doing deals then he wants…. deals!

He probably also wants investors and partners.

And he probably also wants new ideas for doing deals or increasing the upside of the deals he is doing.

Maybe he also wants expertise in areas he doesn't have – e.g., he is building a mixed use project with a hotel and he has never really done hotels before!

If he is leasing space, he will want tenants.

And no matter what he is doing he will want connections to people who can help him succeed in this project or the future.

And for any particular borrower, there is probably a lot more that he wants.

So now that we have an idea of what the borrower wants, what's next?

I advocate that you follow the two steps I did in growing my law firm.

In that regard, the first thing to do is to define your market to be smaller than it likely is right now. Instead of the market being possibly the entire universe of U.S. mezzanine lending, including most product types, I suggest that you select a smaller niche market– a niche market that you can "own" and in which you can have pricing power.

The encapsulation of the idea is that your smaller market is one where you can achieve a monopoly (or close to it). And what do we know about monopolies? Monopolies are great things for the monopolists, since they give them so much pricing power.

Hearken now back to Mr. Porter, who I started this talk with, and consider that strategy is determining what "not" to do. In that regard, I am advocating narrowing your focus to this smaller market and basically "not" doing everything else.

Possibly you could even call yourself a "pure play" in this market?

The second thing you do, is focus your marketing efforts to make yourself useful to the borrower to be able to deliver to the borrower what it wants, i.e. you focus on your customer's wants rather than your own.

This is kind of vague…..so let me put some meat on the bones. Let's pick a hypothetical example and let me show you exactly what I mean. Pretend you decide to "only" do mezzanine lending in the retail space – period!!!

You spend your time meeting everyone in the retail world. You meet the borrowers, the lenders, the credit tenants, the non-credit tenants, the retail leasing brokers, the lawyers with this expertise. You meet everyone!

You are not proud. You meet the little guys with nothing but a gleam in their eyes starting up a business. And you meet Blackstone's retail group (if they have one). And you meet everyone in between.

Your goal is not to look at these parties as possible borrowers. You are just developing your network as the mezzanine lender to the retail world.

And you help everyone all the time. You constantly spread good karma connecting people even if there is nothing in it for yourself. Of course you hope people will reward you some way (you are not a saint) – just as I admit I hope my clients and others will send us legal work when we help them out. But there is no quid pro quo – you just hope for it.

At the same time, you recognize that knowledge is power. So you build on your expertise in your niche. You read everything you can and learn whatever you don't already know. You subscribe to every retail magazine you can in the retail world. You have your assistant go through five newspapers a day and cut out every article on retail and give it to you to read. Pretty soon there is nothing you don't know about your niche. You move from expert to guru.

Then you get out and about. You go everywhere in the retail world – you go to every event – you meet everyone you can – you speak when you can. You even write articles.

Lastly, you tell everyone what you are doing constantly. People see you coming and say inwardly "oh here is that (annoying?) retail guy. I bet he is going to talk about retail again….."

Within a year (or even less), you – and your business – are very different!!!!

You used to be someone who, from your customer's point of view, was largely indistinguishable from everyone else and selling something that was largely a commodity. Now you are a mezzanine lending retail expert! You know everyone and everything in your niche. You have done zillions of favors for everyone. You have given tons of free advice to many people. Writers of articles on retail call you for comment. You are looked up to as a true expert – indeed, a guru – in your niche.

Consider now how you are looked at by:

Borrowers?

Investors in your fund?

Senior lenders?

Everyone else?

Instead of competing to sell a commodity like money, now everyone "wants" you around based on your intellectual capital and skills and expertise.

This strategy – of narrowing your focus to a niche that you can "own" – and then learning everything there is to know about this niche – is counterintuitive. It seems like you are shrinking your market; however, instead you are creating as close as possible to a monopoly in a smaller market. And as I noted a moment ago, a monopoly is a great place for the monopolist.

My view is that this focused strategy will not only will help you find loan product, it will also help you charge a premium price for your money, as you will be the guy with the expertise – the guy with the contacts – the guy who could save the day if the deal gets into trouble. That is what you will have a monopoly on!

Dare maybe to dream – possibly the first lender will demand that you be the mezz because they want a retail expert around if the deal goes South. Or the borrower will start seeking you out for his projects because you could maybe help him find tenants or give him good advice about holes in his deals and how to plug them. Sky's the limit!

Now try this on for size when someone asks you what you do. Consider if you could describe yourself this way:

"We do mezzanine lending solely in the retail area. There are an awful lot of people who just lend mezzanine debt. We "only" do retail. Retail is very tricky stuff because of tenant mix and other factors. Most people don't even realize how difficult it is until they find themselves in a shopping center where the anchor tenant goes dark and the lender starts foreclosing or the capital stack becomes stressed. We have spent a zillion hours and done a zillion deals in this space. We know everyone including the tenants, the builders, the lenders, and the other players. We are true experts in everything about retail. If you want mezzanine debt outside retail we do it of course but I admit we don't add particular value. But in retail, everyone wants us in the deal. The borrower likes that we can find tenants – the lender likes that we can rescue the deal if it gets in trouble – and everyone likes us to evaluate the deal and look for the holes and the trouble spots. But our money isn't cheap. We provide real value – this is "our" market".

If you are considering from whom to obtain a mezzanine loan in the retail space, I think this is pretty powerful. I would want the guy who can say this.

Now you may be listening here and thinking you don't need this. Maybe you are already a major – and successful – player, which of course I fully respect. In that regard, I will add one thought here and that is that no matter how big a player you are, part of what you do is develop the junior talent at your organization. Often youngsters don't know what to do at the start of their careers. This strategy may be a useful one for them. It allows them to carve out a niche and become useful at a much younger age.

To end where I started – with the advice from the sage Mr. Porter – if you follow the plan I have outlined, you will have created a strategy based on what you are "not" doing and you will have put yourself in a position where you have deep value to your customers based on your expertise and intellectual capital in a small market that you own (or monopolize).

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To conclude my words this morning – as many of you now know, we at Duval & Stachenfeld specialize in unusual intellectual conference gifts that usually tie to my speeches. This morning it should be no surprise that the gift today is *Understanding Michael Porter: The Essential Guide to Competition and Strategy,* which is a compilation of Porter's revolutionary thinking. Feel free to visit our booth to get one these gifts.

So now here you are at this conference. As you go out the rest of today, you will be able to speak with many brilliant and connected and talented people. As you circulate and speak to them, perhaps you might think about meeting these same people next year and how much more powerful and useful your meetings might be if you could talk about the "one area" that you are truly an expert in – that you "own"; indeed, your own monopoly.

Have a great day and please enjoy the conference.