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## DUVAL & STACHENFELD LLP

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**Keynote Address by Managing Partner Bruce Stachenfeld at  
IMN's 2013 Borrower & Investor Forum on Real Estate  
Mezzanine Financing & Subordinated Debt**

I admit I am a little afraid to give this little speech to you people this morning. But here goes, my speech is titled:

Money doesn't mean a thing!

Let me start with a story. This is the story of Enterprise Rent-A-Car. I am sure you all know the company. They started out I think about 30 or 40 years ago. And they started out by renting cars "not" at the airport!

Think about that! 100% of their competition rented the cars at the airport – and with good reason. Just about everyone who is renting a car gets off a plane and rents a car.....What was Enterprise thinking?

I admit I don't know what they were thinking but what they did was they placed their rental outlets into smallish communities all over the U.S. Often in towns that could support at most one rental outlet – and then they hired younger people who lived in the community and supported all the local businesses – and they became a fixture in the community.

So now fast-forward 30 years.....what has happened?

Enterprise has a zillion outlets all over the place. In each town they own their market. There is no room for competitors in the locations they are at. They rent fewer cars than at the airport but at lush profit margins – lovely not to have competition isn't it?

And they make an absolute fortune. The guy who founded the company is I think the 24th richest man in the country.

Along the way, every other rental car company (I think just about all of them) has gone bankrupt. And the reason why is easy to see. If you go to the airport the efficiency and skill set of the car companies is almost astonishing. As soon as one airport rental car company comes up with an idea everyone else copies it immediately. But the laws of perfect competition eviscerate their profit margins.

So now – today – the guy who did things differently (who rented cars “not” at the airport) makes more revenues than all the other rental car companies put together.

So how does that sound to you for your business?

You aren’t renting cars. You are effectively renting money? And obviously it would be a lot better to be like Enterprise than Budget Rent A Car

If you look around the room, how many dumb people do you see? Not many – hopefully not any. These are smart and talented people all going after the same deals.....and just about every week I hear about another client going into this same business. I do hear talk of that tidal wave of debt coming to refinance – but I don’t believe for a minute it will unleash a feeding frenzy of awesome deals.

If you agree with me so far, there is an overcapacity problem brewing for those in the money business – but there are some solutions – which is the reason I am here this morning.....

Let me take ten seconds to introduce myself....my name is Bruce Stachenfeld. I am the Managing Partner of Duval & Stachenfeld. We are a 75 lawyer law firm in mid-town Manhattan. About 55 of my lawyers are real estate lawyers, which I think is the largest real estate law practice in New York City. We call ourselves The Pure Play in Real Estate because all of the practices in the firm (litigation, corporate, tax, etc.) are centered around real estate. So instead of being a full-service firm like my competition we are a category-killer – best of breed in real estate.

But enough about me – let’s talk about how to solve the problem I just alluded to and how to solve it.

First, let’s talk about what I personally doubt is going to work.....

First (what won’t work) – setting up your business as a bet on macro trends and believing that you are going to be able to outsmart the world and predict the future of interest rates, cape rates, etc. You may get some positive reinforcement that for a time leads you to believe you are Nostradamus but sooner or later you will revert to the mean. For example, how many people were “sure” interest rates were going to rise five years ago?

Second (what also won’t work) – outdoing your competition on pricing to get deals. All that will happen is that you will indeed get deals, however, most likely your risk/reward on those deals will be worse than your competition’s (by definition). It is really the same thing as a buyer in a widely marketed deal winning the bid just by paying more than anyone else. This is not a recipe for success – and it is the reason why people don’t like widely marketed deals. Unless you are really smarter than your competition sooner or later you will get nailed.

Third (what also won't work) – picking a market where there is less competition. This may seem like a great idea, but there are two flaws in it. First, there is almost always a good reason why that market has less competition and unless you really see something no one else does you are just taking on more risk for more reward but not necessarily improving your overall results. Second, if you are really right about that market, this won't last very long. Consider the obvious migration of mezz deals from “only” major markets (for liquidity) to secondary and tertiary markets that occurred over the past 18 months. Two years ago no one would do it and now there are various parties who will.

Fourth and finally (what also won't work) – having the ability to move fast. The bottom line is that just about everyone in this room can move fast for a good deal.

Okay, that is kind of depressing – things that won't work. Now let's get a little more energized and positive and figure out what will work.

In this regard, I advocate a strategy called the “Blue Ocean Strategy” – from a book I will mention in a few minutes. Its concept is that in one place the ocean is red – it is red from the blood of competition – the competitors are ripping each other to pieces for market share and customers (just like the rental cars at the airport) and their blood makes the water red. You are one of the competitors and you say “I've had enough....I can't stand all this competition any more....I am swimming away....to a Blue Ocean.....and I will do something different where there is no competition (just like Enterprise Rent-A-Car did).”

Now this is easy to say but very hard to do. For example, in the law industry it took me many years, and a lot of soul-searching, to come up with our Pure Play in Real Estate strategy. Consider the fear we had that this pure real estate focus would turn off all non-real estate clients, which after all are 98% of the clients in the world? Won't we lose all the other clients! But the idea has turned out to be explosive for us – and the fulcrum of our success. Even I didn't realize how powerful it was when we started, for the mission statement attracts not only clients but also attracts the best real estate lawyers in the world, who of course want to come to the firm that has real estate as its sole reason for existence.

So now here are some blue oceans for your business that I think might be helpful.

1. First, I suggest that you consider focusing yourself narrowly on niche markets. This is a very powerful – and exciting idea – but it is counterintuitive. Indeed, the smaller the markets you are in the more powerful your pricing can be, since you will “own” the market – just like Enterprise did. In this regard, consider difficult areas like

Garages and parking lots  
Medical office

Boutique hotels  
RV parks  
Recreational communities  
Manufactured homes  
Agriculture  
Timber  
Data Centers  
Energy related “stuff”  
Student housing  
Governmental entity deals

Of all the ideas I have this morning, this might be the best. I tell my young lawyers this all the time. Pick a smaller area that no one else owns and own it and be the best in the world at it and people who want the best at any cost will pay any price for your services, as opposed to competing in a commodity law business.

This is an incredibly exciting proposition so let me digress for a moment. Let’s say you targeted mezz lending on projects with medical office and that was “all” you did – and every single person you met here at this conference you started talking about medical offices to – then what would happen?

I will tell you what would happen. After the conference no one would remember anyone they met except you! Because everyone else would simply blend in. And every single time anyone heard the words “medical office” they would remember that guy they met at this conference who focuses on medical office mezz.

And even more powerful is the fact that even a year later if someone mentioned “medical office” to anyone that you met at this conference they would say something like “You know there was that weird guy at the mezz conference that “only” did medical mezz—what was his name again?” Indeed, I suspect that if you really delved into it to become an expert in the area you could own that market. With no competition and lush profit margins.

If you go further, even competitors making loans in this area would call you and offer you a piece of the deal if you would provide your knowledge and expertise. Notably you wouldn’t be a competitive threat due to your being solely in your niche.

Oh and did I mention, if you talk to the people you are raising money from they will almost all tell you they like smaller focused funds nowadays for this reason. Still another reason why I love this idea.

2. For a second strategy, let me get a bit intellectual with you this morning. This is from a Harvard Business Review article I just read over the weekend. The point made is that complex strategies have a brutal irony in them in that:

Complex strategies are the ones that have the greatest chance of success

But they confuse investors – and most of the time investors just don't care enough or have the intellectual bandwidth to figure them out.

So you are all dressed up with no place to go.....

So how does this strategy work if investors don't like it? Well the answer is you just have to tough it out – keep looking for money – speak to people like me and other aardvark sources of money-raising – and not be discouraged when everyone tells you that you are wasting your time. Then when you finally prove it works and things go well you have more money chasing you than you can believe.

3. For a third strategy, consider (on some deals) don't think of yourself as a lender ..... gasp .....climb up the capital stack higher than your competition and turn the essence of what you are doing on its head. For example, go to 95% of the capital stack and charge a ridiculously high interest rate for the sliver over 80% or 90% – and maybe even a higher rate for the rest of the financing. The borrower is often incredibly optimistic about his project – that is always the mind-set of a borrower. Indeed, they often have an intellectual blind-spot in seeing the upside but not as much the downside. If you look at this strategy one way, you have a poor debt deal with incredibly high leverage. But if you put on a different hat you have an incredibly good equity deal. I don't advocate this in every deal, but sometimes this is just right for the risk and reward presented to you.

4. I suspect that no one will like this fourth strategy – but consider raising much smaller funds! There are good mathematical reasons for this. First, the smaller the fund, the smaller the base you have to exploit to earn a promote for yourself and therefore mathematically the more likely you are to succeed. Second, and even more importantly, the bigger the fund the longer it takes to raise and put the money out. But markets change – and fast – you may have a billion dollar mezz fund and have it half put out and then the market changes so the product you are selling just isn't a good one. Now what? I guess you could give the money back but why raise it in the first place.

5. For a fifth strategy, I urge you to train your lawyers properly – challenge them to come up with unique structures to solve problems and to even help you build your businesses.

Make sure they are nice lawyers – yes nice lawyers. If your lawyers act like unfriendly, un-emotive, uncaring people then people will think you are the same way – they are your agents after all.

Insist that your lawyers create deals for you with their relationships. If all they are doing is cranking out commodity work themselves then, sorry, they are easily replaced with a law firm that is creating ideas and opportunities for you.

6. Sixth – and finally – have it as your mission to attract, train and retain talent. This is exactly our mission with our firm. As Jim Collins points out in his great book *Built to Last* – it is much more important to get the right people on the bus than to figure out where the bus is going. When you start or run a business the only thing you can be sure of is that whatever you plan for won't happen. If you surround yourself with average or below-average people, then when something goes wrong or not-as-planned, these people can provide limited utility. However, if you have great people around, then one way or another they will find a way to succeed. I made a whole speech a couple of years ago about attracting talent and obviously I can't go into that here, but I will say the most important point which is that to be a boss today you aren't really the boss – you have to be a leader – an inspiration – or your talent will just go somewhere else and take all that you have built with them. How about if you ask yourself the question – would you want to work for you and if so why?

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So I did the best I could here – as a lawyer – to come up with some blue oceans for your businesses. I have another bunch of ideas – about another ten – I hated cutting down this speech actually – but there is no time left now.

My overall point is not necessarily that my ideas are the ones to do – but that it is important in your business to seek out these blue oceans one way or another.

Now I do want to give credit where credit is due. So I want to mention a book I read that sparked this kind of thinking in me and was transformative in the development of my law firm. It is called (you guessed it!) *The Blue Ocean Strategy* and it takes you deeper into the kind of thinking that I am outlining this morning.

In this regard, I hope you will visit our booth at this conference. If you do my Director of Business Development and Client Relations, Caitlin Velez, will be happy to give you a copy of this excellent book.

So I will leave you with this. As you go through this conference you will have a chance to learn a bunch of things and hopefully meet a bunch of people. Instead of only talking about cap rates and the future of interest rates or the difficulty of lassoing deals (or whatever you business guys talk about), consider keeping in mind the realization that:

Money doesn't mean a thing!

And consider starting a discussion about blue ocean strategies.

Thank you all for coming this morning.