PATHFINDER PARTNERS, LLC

The path to innovative real estate transactions.

The Pathfinder Report June, 2012

In This Issue

Thanks for Writing In

Charting the Course: 2012: **An Inflection Point?**

Recent Pathfinder Closed Transactions

Finding Your Path: **Our "Top 10 Bank SNAFUs" List**

Zeitgeist: News Highlights

Trailblazing: **Wellshire Arms, Denver, CO**

Notables and Quotables

Dear Reader,

The Pathfinder Report is a complimentary publication focusing on issues and trends relating to commercial loans and real estate. If you have colleagues who may benefit from The Pathfinder Report, please add their email addresses by clicking the link below:

Subscribe to Newsletter

Quick Links

About Us
Newsletter Archive
Announcements

THANKS FOR WRITING IN

Thanks for writing in. Please keep those cards and letters coming.

If you have expertise in an area that could be of interest to our readers, please email us at info@pathfinderfunds.com with information about your proposed subject matter – we will be happy to consider it for a future edition.

CHARTING THE COURSE

An Inflection Point?

By Mitch Siegler, Senior Managing Director

Calculus (not our best subject) introduced us to the inflection point, the point on the curve where curvature or concavity changes from plus to minus or minus to plus. (Or, as the Chinese teaching assistant explained, "If you're driving on a winding road, inflection is the point where the steering-wheel is momentarily 'straight' when being turned left to right.")

As events unfold – the Facebook fiasco, the multi-billion Euro game of chicken between Greece and Germany, the continuing economic slowdown in China and further signs of strain in the U.S. economy and housing market – we're struck by the distinct likelihood that this summer could be an inflection point.

Facebook falls flat

Unless you've been living in a cave – without access to social networks – for the past month, you'll know that the much ballyhooed Facebook public offering fizzled and the stock price fell about 30% – from the $38 IPO price to $27 before recovering a bit recently. While comparisons to the Internet bubble of 1999-2000 are overblown, this feels like a harbinger of change in the equity markets.

Global equity markets are edgy (the May decline in stock prices is basically a give-back of everything gained in the first four months of the year) and credit markets are stressed (ten-year treasury yields are around 1.6%). Everything is inter-connected and – as we've been saying for years – deflation remains the dominant theme.

Which way Europe?

A year ago, it took $1.43 to buy a Euro. At press time, one can be had for $1.27. The European integration experiment is failing, as we have been predicting for several years.

In May, Spain pumped €19 billion ($24 billion) to bailout Bankia SA, the country's third-largest bank. In June, Spain received a €100 billion ($125 billion) credit line commitment (we've dubbed it a "Spailout") from other Euro countries to prop up the other seven large Spanish banks. It's a tidy sum that should buy Spain some time to deal with its massive overhang of non-performing property loans and 25% unemployment rate. It may even narrow the massive yield spread between Spanish and German 10-year bonds. (Spain's 10-year yields are around 7% while Germany's 10-year bund yields are below 1.5%.)

A Pew Research Center poll, released in late May, found that citizens of eight different

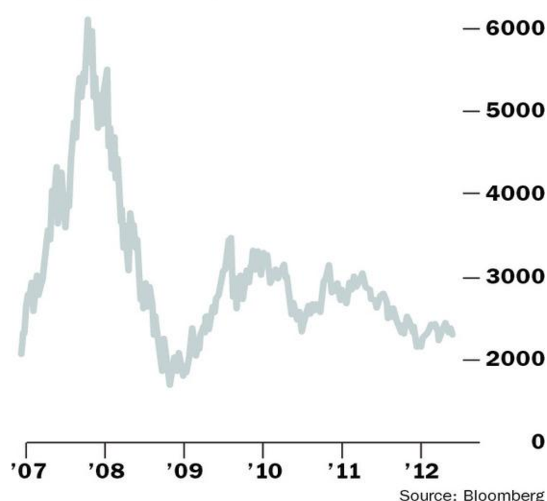
European countries had widely divergent views on the E.U. and Euro. Here's a shocker: Germans and Greeks are at opposite ends of the spectrum. A quick summary: Europeans oppose fiscal austerity to deal with the crisis and are split on bailing out indebted nations.

When Aristotle famously said "The Gods, too, are fond of a joke," he couldn't have known about the chaos (a Greek word) in Greece, circa 2012. Whether Berlin answers Athens' pleas for leniency with a *ja* or a *nein* could also impact the fate of Spain and Italy – and the entire Euro zone. It's really all Greek to us.

The next country to watch is Italy, whose 10-year bond yields are north of 6.3%. Citigroup just warned that Italy's economy will shrink by 2.5% in 2012 and another 2% in 2013 as austerity kicks in – with ugly ramifications for Rome's ability to debt service. As usual, Mr. Market is signaling its concerns that Italy is the next Euro problem child; Italian equities haven't been this cheap (adjusted for inflation) since Mussolini was in power.

How do you say "economic slowdown" in Chinese?

With Europe in the tank and Japan's economic stagnation now at 20 years, world economic growth hinges, in no small part, on Beijing – and whether China's economic miracle is taking a breather. We think the picture below – which shows that the Shanghai composite index, which peaked above 6,000 in 2007 and is now bumping along around 2,300 – is worth the proverbial 1,000 words.



When the U.S. real estate market cratered, consumer confidence stalled and exports declined, we all understood what that meant for the economy. In China, where the state spins the stats, it's harder to read the tea leaves. When usually closed-mouthed Chinese Cabinet advisors use words like "slowdown" and the central bank slashes interest rates again (both of which occurred this month), it's easy to see the future without the benefit of a fortune cookie.

First quarter, 2012 economic growth was virtually nonexistent. April retail sales grew at their slowest pace in three years. Growth in capital spending (bulldozers, steamrollers, excavating equipment and other toys boys like) is at the lowest level since 2001. Construction activity is dismal. Real estate prices are falling in a majority of the country's 70 largest urban markets. Steel production is down (not just slowing, but down!) sharply year-over-year.

Prices for iron ore, copper and other commodities have been tumbling for months, as fears that economic growth in Beijing, the world's economic engine, is stalling. And, many state-

owned banks appear vulnerable to non-performing loans to sketchy property developers and politically influential borrowers. Who knows where the Chinese economy is heading and how it could impact Europe and the U.S.? But, we're reminded of the wisdom of Confucius, who famously said, "The cautious seldom err."

We know how to say "slowdown" in English

The May jobs report was – in a word – ugly. Just 69,000 jobs were created, half the expected level. The April increase was revised lower by 38,000 jobs. And, unemployment moved up for the first time in 11 months to 8.2%. We like to look on the bright side but it's not easy with this data. We'll end this section on a happy note nonetheless: a wobbly economy helps the challenger come November.

Whither housing?

Housing will lead the recovery, they say. We can't have a vibrant economy with housing in the tank, they say. As we parse the recent news, there are data points that would allow one to make a bullish or a bearish case (watch us do both). Among the positives:

- Six years after home prices peaked, many U.S. housing markets are entering a bottoming process. While a complete recovery seems years away, bouncing along the bottom is a necessary step toward an eventual recovery.

- The National Association of Realtors' index of the number of contracts signed to purchase previously owned homes rose in March to its highest level since 2010 – up 12.8% over 2011 and 4.1% over the February level. April remained positive, up 3.4% over prior year.

- "We very much believe we've hit bottom," says Ivy Zelman, CEO of the eponymous housing research firm, Zelman & Associates. Ms. Zelman was among the first to warn of the impending housing collapse in 2005. In May, she raised her 2012 home-price forecast, predicting a 1% increase, up from the previous prediction for a 1% decrease.

Meanwhile, from the bearish camp:

- In April, U.S. pending home sales plummeted 5.5%, the biggest decline in a year and the first down month of 2012.

- More than one million Americans who have taken out mortgages *in the past two years* now owe more on their loans than their homes are worth, per Reuters. Of course, Federal Housing Administration loans that require a meager 3.5% down payment bear some off the blame. FHA loans

account for one in ten home loans made since 2010, according to CoreLogic.

- As of December, 2011, 31% of U.S. homes were underwater – meaning the outstanding loan balance exceeds the value of the home, per CoreLogic.

- According to the S&P/Case-Shiller 20-city composite index, which tracks home values in 20 major U.S. metro areas, home prices fell 2.6% in March from a year earlier and are now at their lowest level since 2002. Over the past 12 months, prices declined in 13 of the 20 major metro areas. (But, some of the hardest hit markets are among the winners, now springing back; Phoenix' prices increased 6% year-over-year and 12 of the 20 markets saw prices rise from February to March – signs of a bottom?)

We're not among the perennial bottom-callers but we do think entry level home prices are bouncing along the bottom, buoyed by historically low mortgage rates and a favorable own vs. rent relationship in many, even the hardest hit, markets. That said, don't look for prices to skyrocket anytime soon.

The times they are a changing – which may impact the housing market for a generation

Inflection points are often only visible in hindsight – after we've rounded the curve, so to speak. Sometimes, generational shifts cause fundamental changes. We see major changes in the works in the housing market.

- **The baby boomers are aging.** Millions of 50 and 60-something empty-nesters are now considering selling their big homes and downsizing. Many may rent. Meanwhile, young people are waiting longer to get married. Marriages between 20-somethings aren't as frequent as they once were. More Gen X and Y folks are waiting until their 30s. So, they don't need to buy a home until later. Many in this constituency rent. There's lots of demand for rental homes and apartments – good news for landlords and sellers of multifamily properties.

- **Home ownership levels hit a 15-year low of 65.4%** – down from a record 69.2% in June, 2004. Millions of Americans can't qualify for a mortgage in today's tighter lending environment. Many who lost their homes to foreclosure now have damaged credit. Others, who lost their equity, can't scrape together a down payment. And, there are millions of Americans who still have a smidgen of equity but can't buy the next home because the costs of selling their old home (brokerage commissions, title and escrow fees and other closing costs) would cause them to lose tens of thousands of dollars that would otherwise have been their down payment.

- **It's cheaper to rent than to own.** Notwithstanding generationally low mortgage rates, it was cheaper to rent than to own in 72% of U.S. cities in the fourth quarter of 2011, according to Moody's. That's up from 54% a decade ago. The more people who

do it, the more socially acceptable it becomes. (Psst: we've been doing it since 2006.)

It's a great time to buy with mortgage rates at generational lows. That's the power of the Fed, pumping gazillions into the economy. Nonetheless, the housing market is not, what most realtors and industry experts (some of the former are actually in the latter category, too) would call a robust, healthy market. Those are the opposing – deflationary, generational shifting, inflection point-type – forces.

Summer is a great time for beach parties and Bar-B-Que's. We wouldn't want our friends and readers to break out their college calculus textbooks or take up differential equations at this stage of life. But, it wouldn't hurt to keep an eye open for economic inflection points – change is in the wind.

Mitch Siegler is Senior Managing Director of Pathfinder Partners, LLC. Prior to co-founding Pathfinder in 2006, Mitch founded and served as CEO of several companies and was a partner with a boutique investment banking and venture capital firm. He can be reached at msiegler@pathfinderfunds.com.

Selected Pathfinder Closed Transactions

Pathfinder Partners, LLC is the sponsor of the Pathfinder Opportunity funds, which acquire with institutional capital partners, distressed real estate properties and the underlying mortgages from financial institutions.

Le Park Apartments

40-unit apartment complex in Long Beach, CA

June, 2012

Pathfinder Partners Opportunity Fund III, L.P.

Investing in distressed real estate assets and the mortgages underlying such properties.

An affiliate of Pathfinder Partners, LLC is the general partner of the fund.

May, 2012

Wellshire Arms Apartments

107-unit apartment complex in Denver, CO

May, 2012

Authentic Broomfield

7-acre multifamily parcel in Broomfield (Denver), CO

April, 2012

View at Redondo Apartments

78-unit apartment complex in Federal Way, WA

March, 2012

Academy Apartments

96-unit apartment complex in Phoenix, AZ

February, 2012

Blake 27

14 residential condominiums in Denver, CO

January, 2012

Chelsea Court

$9,300,000 defaulted senior mortgage on 29 new condominiums in Kirkland, WA

January, 2012

Shorewood Apartments

21-unit apartment complex in Phoenix, AZ

January, 2012

Grant Street Mansion

23,000 square foot historically designated office mansion in Denver, CO

December, 2011

Vista Lago Apartments

$3,200,000 defaulted senior mortgage on 102-unit apartment in Austin, TX

September, 2011

Barolo Place Condos

16 residential condominiums in Scottsdale, AZ

August, 2011

FINDING YOUR PATH

Our "Top 10 Bank SNAFUs" List

By Lorne Polger, Senior Managing Director

I've always been a big fan of the *David Letterman Show*, especially the famous "Top Ten" lists. Thanks to Dave for inspiring our "Top 10 Bank SNAFUs" list – essentially, the most moronic things we've seen financial institutions do in conjunction with selling their distressed notes and properties. After all, Pathfinder has been buying distressed assets for over six years, so we've pretty much seen every distressed real estate "stupid pet trick." And, I have a reputation as a pretty decent storyteller. So, without further ado (drum roll, please), here's our "Top 10 Bank SNAFUs" list.

Number 10. List the REO building for sale with all 40 windows broken. While you're at it, there's really no reason to clean up the broken glass on the floors left by the bad borrower who decided to buy a case of beer, invite a few friends over, and take a sledgehammer to his office building the night before the scheduled foreclosure sale. I'll just step over the piles of glass as I'm walking through the project. It really sets the stage for a good showing and gives such a nice feeling of "potential" to a buyer.

Number 9. Power-wash one tiled roof in a 20-building project and call it a day. Really, nothing looks better than a project with one shiny red roof and nineteen dingy, burgundy/sun-bleached orange ones. The lender actually told us with a straight face that there was a value-add component to be realized by power-washing the remaining roofs. Funny – he was stumped when I asked him where the black mold would drain?

Number 8. Use a team of residential sales associates to market your REO multifamily project. While these folks have really snazzy photos of themselves on their coffee cups and business cards, they've never sold a commercial asset before. But, the bank president's wife is a partner at the local residential brokerage office, the office's LoopNet subscription is current and why let details like prior experience get in the way of a good commission?

Number 7. Require a $10,000 nonrefundable deposit to review the bank's diligence materials. In an environment where prolific buyers like us are presented with 100 new deals every week, these types of artificial barriers to entry are sure to stimulate more buyer demand. Instead of deleting those emails after a 30-second review, we take about 10 seconds in this case.

Number 6. Base the asking price for the REO commercial real estate asset on the 2007 loan amount rather than the current fair market value (i.e., how could we sell it for $3,000,000, when we loaned $6,000,000 on it back in 2007?). After all, those 2007 dynamics have a lot

of relevance these days. Since the average commercial property value has declined by nearly half since the 2007 peak, this sort of numbskull maneuver is typically met with our applying the "50% Mensa discount."

Number 5. Create additional barriers to entry like only permitting the review of the loan documents in the company's home office in Sheboygan, Wisconsin. In February. During regular winter office hours of Noon to 2 p.m. And by the way, the office will be closed in honor of Bucky the Badger Week. (We were pleased to see the forward-thinking Dairy State voters reelect their anti-union governor – surely, banks up there have heard of document scanning and email?)

Number 4. Don't clean the building. For two years. And keep the power off (wouldn't want to have those massive utility bills for discretionary items like heating and cooling). So what if the pipes freeze and you have to replace $50,000 of new flooring? And don't bother cleaning out the refrigerator where the last borrower's employees kept their lunches. I'll remember that tuna fish smell for the rest of my life.

Number 3. Fail to disclose that the property was recently the scene of violent criminal activity. While you are at it, don't bring up the lawsuits and administrative hearings that followed. Can't imagine why that would be a material issue to a buyer, right? (Even in Wisconsin they know how to use Google to search for these things.)

Number 2. Ask me for a job with our company while you're touring me through your property. This tactic never fails to impress and always shows the bank's position of strength. It certainly doesn't give rise to a potential conflict of interest, does it?

And now, the top moronic sales tactic for a distressed real estate loan or asset:

Number 1. Step over the dollar to pick up the dime. We've seen it time and again. Why spend $500 to put plastic wrap on the windows of the new condo project? The boss says we've gotta keep a close eye on operating expenses. Gee, it's probably not going to rain much this winter – in Seattle. We'll deal with the ruined flooring and mold remediation later through a massive price discount upon sale. And, if you hate spending $500 on plastic wrap, you're really going to cringe at spending $1,000 to water the lawns. In Palm Springs. In the summer. Better to give a $50,000 landscaping credit at closing.

It wouldn't be the first time I bent the truth a wee bit for purposes of enhancing comedic value, but you just can't make this stuff up.

Lorne Polger is Senior Managing Director of Pathfinder Partners, LLC. Prior to co-founding Pathfinder in 2006, Lorne was a partner with a leading San Diego law firm, where he headed the Real Estate, Land Use and Environmental Law group. He can be reached at lpolger@pathfinderfunds.com.

ZEITGEIST – SIGN OF THE TIMES

A compendium of notable news articles relating to the economy, commercial lending and real estate which we've edited and commented upon.

Embarrassment at JPMorgan Chase

As Jamie Dimon, JPMorgan's Chairman and CEO strives to unravel the bank's $2 billion+ trading loss and senators, congressmen, the SEC, the FBI and the rest of that merry band of helpful regulators who brought us Sarbanes-Oxley and Dodd-Frank trip over each other to pile on more regulations to, once again, prevent this type of thing from ever happening again, one thing is clear: the Fed's zero interest rate policy is at least partially to blame.

JPMorgan's screw-up came about because the bank was reaching for yield, like American retirees and others on fixed incomes are doing. When the income from their standard fare fixed income instruments (Treasury securities, bank CD's, municipal bonds and the like) is no longer sufficient to make ends meet in a low-rate environment, their last remaining alternative is to buy riskier assets.

As the Fed buys up every Treasury in sight, driving yields on the 2-year down to about 0.25% and on the 10-year to about 1.6%, investors are forced to suck it up with similar yields or to chase riskier assets – stocks, REITs, below-investment grade (junk) bonds – which explains the stock market' pretty stellar performance the past three years in what passes for a massive deleveraging environment.

JPMorgan has about $700 billion more in deposits (liabilities) than it does loans (assets) so it has to do something with the excess cash. According to the bank's first quarter 10-Q, the recently retired head of the Chief Investment Office had $374 billion of securities, which Mr. Dimon and other executives assumed were vanilla instruments merely hedging JPM's credit risk. As we're now discovering, the securities come in plenty of other flavors, including fancy derivatives, the same type of thing that caused AIG to implode in 2008 and Warren Buffett to dub "financial weapons of mass destruction."

[Editor's Note: What's going to happen when the Fed decides to sell off its ginormous Treasury portfolio? (Psst, here's a secret: The Fed is simply never going to sell off these securities, as doing so would crush the stock and real estate markets.)]

Trouble Across the Pond

When Greece began experiencing financial problems several years ago, the European Central Bank created a variety of funds – guaranteed jointly and severally – to serve as a firewall to prevent Greek flu from infecting other European countries. All of these hundreds of billions have not been enough to prevent a Greek default or the value of "new" Greek bonds from collapsing to about $.10 on the dollar.

The European Union and the Euro currency can muddle along without Greece. And, they can probably handle a domino effect in Portugal. But Spain and Italy are much larger – a different story altogether. And the dominoes seem set to fall.

Italy is paying 6% interest rates on its bonds and spending an equivalent amount, as a percentage of GDP, simply to cover the interest on its debt. Non-performing loans at Spanish banks are now at 20% of their capital; banks in the U.S. are closed when this ratio hits 5%. Last month, the government nationalized Bankia, Spain's third largest bank with nearly 50% of its loans in non-performing status. Analysts estimate that Spanish banks will need €200 billion ($250 billion) in recapitalizations this year in order to reach the target capital ratio. And, that's if the economy doesn't get any worse. The €100 ($125 billion) credit line coming from other Euro countries will certainly help but if history is a guide, there's more to come.

Now, *mon ami*, let's move on to France. Paris has not balanced its budget since 1974, public debt is 90% of GDP, budget deficits have been north of 8% for several years and the country has operated a trade deficit for a decade. French bank assets total 300% of French GDP, with many French bank stocks down more than 80% since their peaks a few years ago. In last month's election, Francoise Hollande, a Socialist, was elected president. He's promised major tax increases on businesses and high earners (75% on €1 million). This, of course, will further crimp innovation and entrepreneurship (a French word but a concept that's been all but dead in France for decades). If you think entitlements are entrenched in the U.S., relative to France, we look positively lean, mean and efficient!

S&P has already downgraded French debt to AA+ with a negative outlook. It's hard to imagine how France could step up to help Germany fend off a larger European (Spain, Italy) crisis while wrestling with the alligators in the form of its own troubled banks, runaway government spending and a new president who promises more social programs. And, it's equally hard to imagine how Germany would feel about going it alone, without help from Paris. Germans still view economics through the prism of the Weimar Republic, when excessive money printing led to hyperinflation.

[Editor's Note: The following European countries are now in recession: Belgium, Czech Republic, Denmark, Greece, Ireland, Italy, Netherlands, Portugal, Slovenia, Spain and the U.K. In France, Sarkozy is out and Hollande, the Socialist candidate, is in – promising higher taxes on the wealthy few and more social programs for everyone else. In Greece, they're having a similar conversation but the police come with barricades and truncheons and the citizens come with Molotov cocktails, breaking shop windows.]

Buying Cheaper Than Renting in Nearly 100 Major U.S. Markets: Trulia

Buying is more affordable than renting in 98 out of the nation's 100 largest metropolitan areas – including New York, L.A. and Boston, according to the real estate company's "rent vs. buy" index, which is based on asking prices for rental units and homes for sale on the company's website between December 1, 2011, and February 29, 2012.

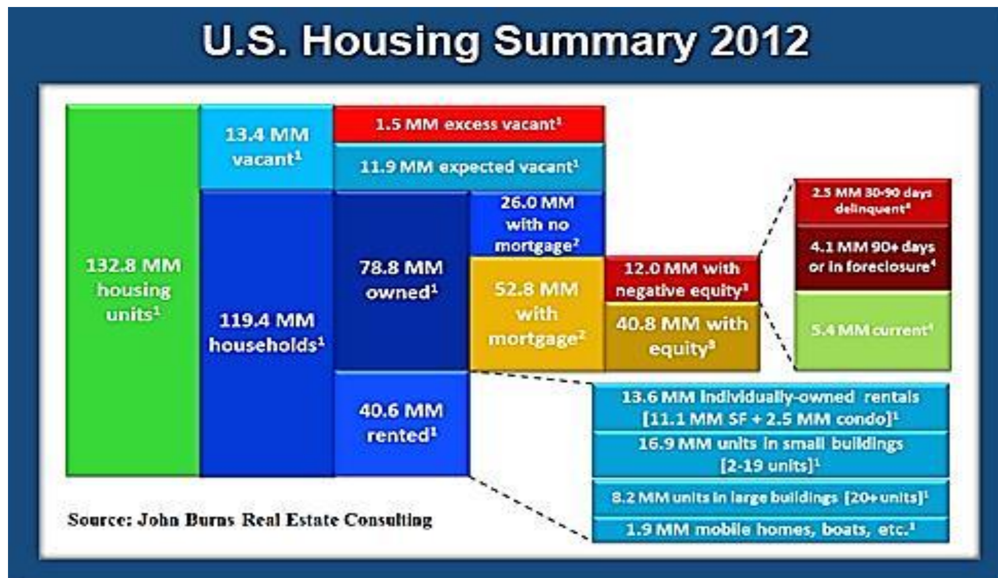
#	U.S. Metro	Price:Rent Ratio
1	Detroit, MI	3.7
2	Oklahoma City, OK	4.3
3	Dayton, OH	4.8
4	Warren-Troy-Farmington Hills, MI	5.4
5	Toledo, OH	6.0
6	Grand Rapids, MI	6.1
7	Cleveland, OH	6.2
8	Atlanta, GA	6.5
9	Gary, IN	6.7
10	Memphis, TN-MS-AR	6.8

"As rents rise and prices stagnate, homeownership is becoming even more affordable, but rising rents create a dilemma for people who can't afford to buy yet," says Jed Kolko, Trulia's chief economist. "Rising rents make it harder for people to save for a down payment, the biggest barrier to buying a home that aspiring homeowners face." Homeowners are choosing, or being forced, to rent rather than buy even though buying is now cheaper in virtually every market Trulia reviewed. But as Americans turn to renting, the higher demand pressures the nation's rental supply, pushing rents higher.

The median rent is now $712 per month – well above the average monthly mortgage cost of $647, according to consultants Capital Economics. The firm forecasts that households in rentals will rise by at least 850,000 per year over each of the next few years and that rental rates will rise by 3% this year and 4% to 5% per year in 2013 to 2015, compared to a 2.4% increase in January.

Housing in One Graphic

We're indebted to John Burns Real Estate Consulting for this graphic and the commentary, below. The picture, worth well more than 1,000 words, does an excellent job of summarizing the U.S. housing market. The red boxes, a small percentage of the total, receive virtually all the media and political attention.



There are plenty of positives, including the fact that:

- 22% of American households own their home free and clear of any mortgage;
- 34% of households own their home and have some equity remaining in it; and
- 34% of households rent

These three constituencies comprise 90% of American households. Of the 40.6 million who rent: 42% rent in a small apartment building, 20% rent in a large apartment building, 27% rent a single family home,6% rent a condo and 5% rent a mobile home, boat, etc.

So, the Burns analysts ask a few great questions:

- Why are some of our leaders asking 90% of Americans to bail out the 10% who have no equity in their home?
- What happens when the 1.5 million excess vacant homes are filled, which is already occurring in many neighborhoods across the country?
- Why is the apartment REIT market so popular with institutional investors, when it accounts for just 20% of rental units?
- What happens when the family renting a home for $1,100/month cleans up their credit and buys the same home with a mortgage payment of $800/month?

Ultimately, Americans will make smart financial decisions. We will bailout very few homeowners. We will increase construction by building in the ever-increasing number of areas that need homes. Investors will invest capital to absorb the overhang of single-family homes. Families will buy homes if it makes financial sense to do so.

Visit John Burns Real Estate Consulting at www.realestateconsulting.com for more info.

Fed Says All Banks Must Comply with Basel III

This month, the Federal Reserve amazed bankers by approving a draft proposal that would require even tiny banks to comply with the comprehensive international standards regulating bank capital known as Basel III. These requirements would apply to all 7,300 U.S. banks.

Many bankers had expected the regulators to exclude small lenders – those with under $1 billion in assets – from the rules. The capital rules will require that banks maintain a ratio of common equity to risk-weighted assets of 4.5% plus an additional 2.5% "capital conservation buffer." The total 7.0% capital requirement compares with current standards, which are as low as 2.0%.

[Editor's Note: While the tougher capital rules won't take effect until 2019, they're a kick in the teeth for thousands of small banks already struggling with sluggish economic growth, new rules limiting fee income and other dynamics that tilt things in favor of large financial institutions. Banks with under $1 billion in assets have seen their share of assets decline from 31% in 1992 to 10% last year, according to the FDIC. Look for dramatically more bank consolidation in the years ahead.]

Phoenix Rising

Phoenix's housing market is as hot as the temperatures, topping 100° by mid-morning this time of year. The market is being buoyed by strong economic and job growth, outstanding affordability levels and robust investor demand.

Once characterized as the poster child of the housing collapse, Phoenix' recent turnaround is downright impressive. In the S&P/Case Shiller report of the 20 largest U.S. housing markets issued on May 29, 12 cities showed price declines and only a handful demonstrated anything more than anemic growth. Median prices in Phoenix were up more than 6%, blowing away the performance of other hard-hit markets like Las Vegas and California's Inland Empire (Riverside-San Bernardino counties). Of course, Phoenix' prices were pummeled in the downturn, declining 57% from 2006 through 2011.

The Phoenix housing market has dramatically improved since 2011 and prices seem to be rising by the week. We think the turnaround is driven by these three factors:

- **Investor buyers** – Our sources report that investors are accounting for 45% of all single-family home buyers in Phoenix. May kicks off the peak summer buying season, when end-user buyers really impact demand. In Phoenix, the combination of the summer buying season and off-the-charts investor demand is creating

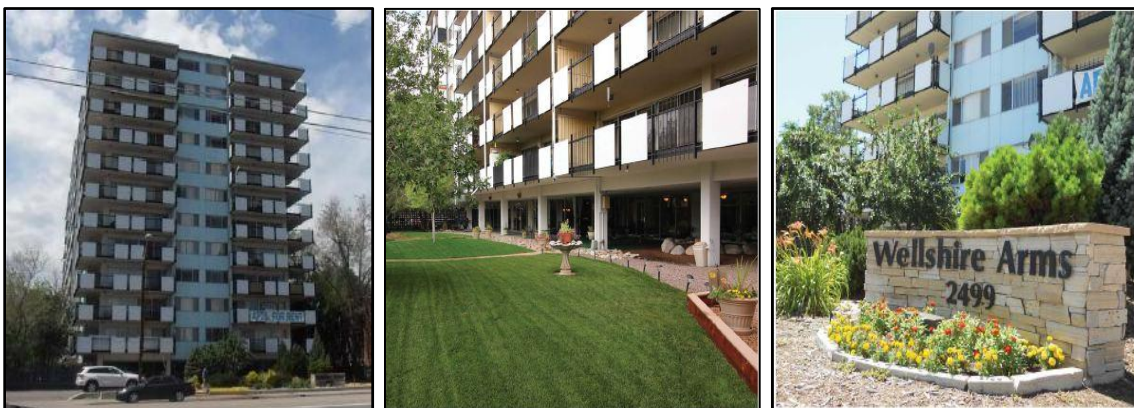
bidding wars where bank-owned homes and short sales are occurring at levels well above asking prices with multiple offers the rule rather than the exception. Phoenix investors are achieving cash-on-cash returns (before any price appreciation) of 7% to 10% on many entry-level homes.

- **Low inventory levels –** Supply is now at an incredibly low 2.5 months, down from nearly five months this time last year and more than 12 months in 2008. Resale listings have fallen 43% since last March and are now as low as they were at the peak of the market in 2005.
- **Strong employment growth** – While Phoenix hosts just a single Fortune 100 headquarters, the majority of the Fortune 100 have a call center, distribution center or both in town. After losing 230,000 jobs (12% of its labor force) from 2008 to 2010, Phoenix has experienced year-over-year job growth for each of the past 17 months. The unemployment rate has also continued to decline, dropping from more than 12% in 2009 to 7.9% in March, 2012. Intel is embarking on a major plant expansion and Amazon is growing like a weed. Our sources tell us that Phoenix was the runner-up in the competition for Apple's recent plant expansion, which will bring 3,000 jobs to Austin. Phoenix is said to be on Apple's short list for future expansions.

[Pathfinder stood on the sidelines from 2006 to 2010. In 2011, we dipped our toe in the water in Phoenix (metaphorically speaking) and have since gone into the market in a big way, with two condominium project acquisitions and two apartment purchases. We're observing, first-hand, the robust conditions in the Phoenix market.]

TRAILBLAZING: WELLSHIRE ARMS, DENVER, CO

Updating a tired apartment building into a modern, spectacular community



When you first see Wellshire Arms – a 103,000 square foot, 12-story, 107-unit apartment building in the Observatory Park neighborhood of Denver, Colorado – it looks like an outdated, 1960s-vintage apartment. Then you look around. To the east are snow-capped

Rocky Mountains; to the south is the exclusive Wellshire neighborhood; and to the north are the dramatic skyscrapers of downtown Denver's skyline.

Wellshire Arms benefits from a grandfathered multi-level zoning advantage – the property is the only high-rise apartment building in the immediate area and no further high-rise buildings can be constructed. Because of the building's height and the lack of additional structures in the surrounding area, all sides of the building have spectacular views. On further review, Wellshire Arms appears to be an irreplaceable gem – a secret many of the property's long-term tenants have been keeping for years.

Constructed in 1962, Wellshire Arms is in a prime, central-Denver location, one mile from the University of Denver and between two of Denver's largest employment and educational centers – downtown Denver and the Southeast Business Corridor. The units average over 980 square feet and provide wrap around balconies, floor-to-ceiling windows and stunning panoramic views. Wellshire Arms is currently 97% occupied.

Pathfinder plans to implement a comprehensive interior and exterior renovation strategy focused on modernizing the building's exterior, enhancing the project's amenities and updating the unit interiors. We believe rents are well below market and there is a significant value-add opportunity for the project. Upon completion of the renovations, we plan to hold the property for cash flow for several years.

NOTABLES AND QUOTABLES – ON "CHANGE"

"People only accept change when they are faced with necessity and only recognize necessity when a crisis is upon them."

- Jean Monnet, French political economist and diplomat (1888-1979)

"The world as we have created it is a process of our thinking. It cannot be changed without changing our thinking."

- Albert Einstein

"Life is a series of natural and spontaneous changes. Don't resist them; that only creates sorrow. Let reality be reality. Let things flow naturally forward in whatever way they like."

- Lao Tzu, Chinese, Taoist philosopher

"God, grant me the serenity to accept the things I cannot change, the courage to change the things I can and the wisdom to know the difference."

- Reinhold Niebuhr, American theologian (1892-1971)

“We change, whether we like it or not.”

- Ralph Waldo Emerson, American essayist and poet (1803-1882)

“Things do not change. We change.”

- Henry David Thoreau, American author, poet and philosopher (1817-1862)

“Change is the only constant.”

- Eskimo proverb

“When you’re finished changing, you’re finished.”

- Benjamin Franklin

“The first step toward change is awareness. The next step is acceptance.”

- Nathaniel Branden, Canadian psychotherapist

Important Disclosures

Copyright 2012, Pathfinder Partners, LLC ("Pathfinder"). All rights reserved. This report is prepared for the use of Pathfinder’s clients and business partners and subscribers to this report and may not be redistributed, retransmitted or disclosed, in whole or in part, or in any form or manner, without our written consent.

Materials prepared by Pathfinder research personnel are based on public information. The information herein was obtained from various sources. Pathfinder does not guarantee the accuracy of the information.

All opinions, projections and estimates constitute the judgment of the authors as of the date of the report and are subject to change without notice.

Nothing in this report or its contents constitutes investment advice. Neither Pathfinder nor any of its directors, officers, employees or consultants accepts any liability whatsoever for any direct, indirect or consequential damages or losses arising from any use of this report or its contents.

Add msiegler@pathfinderfunds.com to your address book to ensure you keep receiving our emails.