In this interview with Mitch, you will learn:

- Why Pathfinder Partners has little competition from other investors.
- How opportunity investors view deals.
- Why the loan-to-own strategy is working for Pathfinder.
- The most important thing to have in an opportunistic deal.
- How Pathfinder creates value.
- Where Mitch see's tomorrows opportunities.

Gain insight into the world of an opportunistic real estate investor by studying this interview with Mitch Siegler. While opportunity investors take on more risk, they also can generate significant returns for investors. See if you can find new ideas in this interview that can be applied to your deals to increase your returns.

Craig: Mitch, tell us about Pathfinder and its business model.

Mitch: Our business model is a classic opportunity fund. We formed the company in late 2005, early 2006, before distressed investing was fashionable. Our thought was that the banks had made a lot of bad loans, the underwriting standards were poor, and a lot of projects were built and developed that probably never should have been, especially as we got later into the cycle. We believed there would be opportunities developing to acquire good quality properties from financial institutions that were financially distressed, at attractive prices.

Our model is to pursue a loan-to-own strategy. We typically buy the loans from the banks and try to create value for the selling banks by virtue of their desire to not step into the shoes of the borrower by foreclosing, to not complete construction; to not spend the time leasing the property up. We'll do those things for them in exchange for acquiring the property at an attractive price and earning returns commensurate with that value-add and the risk.

Craig: Do you think the opportunities today are pretty good?

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Mitch: There are good opportunities out there. It's a little bit "A tale of two cities." If you're trying to buy large, institutional-grade assets, the trophy properties in the biggest markets, you should be prepared to have 20 other people competing with you. For a Class A apartment building or office building in New York or Washington or San Francisco or Chicago, you might be looking at a four or five cap rate, which is not our business. That's not what we want to do.

Craig: Secondary markets?

Mitch: Not so much. We like to fly under the radar screen in a few ways. We like to, for example, only paint a picture of what we don't want. So we don't want the listed deal with the national brokerage firm for the $30 million, 98%-leased, fully-built, brand-new apartment building because there's a feeding frenzy for those assets. Instead, if a large institution needs to put $10 or $20 million to work to move the needle on their business, if we can be below that; and if we can buy the $80 million deal that's too small for those big institutions; if we can buy the loan instead of the property – because not everybody has the expertise to buy the loan; if we can buy a property that has $2 million of remaining construction – because not everybody wants to do that, or that doesn't have certificates of occupancy in, and isn't leased up, and we find opportunities that maybe have many or all of those attributes, we can create value in a lot of different ways.

Craig: As you buy some of these loans, what types of challenges have you had?

Mitch: We've had a couple of bankruptcies along the way – borrower bankruptcies. We knew they were coming so we underwrote for them and we planned on them. They weren't unanticipated, but that's the kind of thing that you can have. You can have situations where you have to clear up mechanic's liens. We generally identify these things early on in the process. We know what they are so they're baked into our price. Cost to complete construction would be another. Big bucket expense item that you can see, then you can underwrite for, that you can build into your pro forma. These are some of the things that can and do occur.

Craig: What platform and strategic alliances have you set up to best position

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your company to take advantage of the opportunities today?

Mitch: We raised our first fund in 2007. We raised a second fund, Pathfinder Partners Opportunity Fund II, in 2009-2010. And we're anticipating having that fully deployed by early next year and being out in the market in the first quarter for fund III. Those are discretionary funds that we have at our control. With those funds, we can strike very quickly, so I would say that the platform includes having access to discretionary capital and having a reputation as a group that underwrites and closes deals very quickly.

We've closed our last half-dozen transactions in 15 to 20 days from issuance of the letter of intent. Pretty quick in any environment, but it's the kind of thing you need to be able to do in today's world, where once a bank finally decides they want to disgorge a property, they want to do it, and they want to do it with a group that can actually perform. Certainty of close to many of these financial institutions is more important than price, or at least as important.

We've seen many, many deals where the bank went under contract with Group A; Group A spent 60 days, and failed to close or tried to re-trade the price. And then they go under contract with Group B at a slightly lower price, which doesn't work out. They look up, and they've been through this process 2 or 3 times, and six months have passed, and it's a new era, and they've spent a bunch of time and management resources and money along the way.

I think many banks have now woken up to the idea that you're not done when you select the guy who tells you what you want to hear. It's better to really understand the value of the asset to select a counter-party that is credible, that can really deliver on what they say and has a track record. Pathfinder has built up a pretty good track record over the last five years, and we have a reputation as a group that can perform. I think that's part of our authority and our branding in the space.

Craig: Are there certain types of assets that you're seeing more of as you're dealing with financial institutions with troubled loans?

Mitch: There's a lot of land, obviously. That's not really in our sweet spot. We're oriented to income-producing assets. We'll look at all the food types that fall under the income-producing umbrella, but we're not buying raw land; we're not buying entitled land; we're not really buying lots, including finished lots. We have bought some, but that's not where we're concentrating.

We want to be in an asset that will generate cash flow, either immediately, or after we finish construction and get it to the point where it can. We're probably not going to buy a 50% completed project, although we've bought several 70 and 80% completed projects. We will do the finish construction but we're not going to do ground-up, vertical construction. We particularly like residential and multifamily. By residential, I mean commercial loans to a developer for a subdivision. Multifamily could include an apartment building, a condo project, a townhome project – anything in that category. People need a place to live, and if we pick our markets well, and we look at the underlying population growth and job growth and so forth, we feel pretty comfortable about that.

We're less sanguine on office. While people need a place to live, they don't always need a place to work, and we've got high unemployment rates. Companies are changing their needs with respect to office space requirements. With retail, it's the same kind of thing. A lot of retail was built in some of these boom cities, like Phoenix, based on new rooftops, and well, some of those rooftops are finished lots today, and some of the rooftops are foreclosed homes, so you don't have the consumer spending in that area that was anticipated. So we're gun-shy about retail.

We've bought an office deal; we bought a retail deal, but 80% of what we've bought has been multifamily and residential. No hotels, no land in the middle of nowhere, no empty office buildings. We're pretty focused.

Craig: As the distressed markets evolve over the coming years, you've been using a fun, hockey metaphor that basically says Pathfinder is getting to where the puck is going versus where it currently is. Can you explain your strategy?

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Mitch: It's Wayne Gretzky's strategy. We just kind of borrowed it from him and are applying it here meaning it's less important where we are right this minute, and more important where we're likely to be in 6, 12, 18, 24 months, depending on the holding period.

We're not trying to forecast interest rates, although we do have a point of view. We're not trying to forecast cap rates, although we do have a point of view. Instead of going to New York or D.C. and buying that four-cap-rate deal, we're trying to identify the market that hasn't quite been discovered yet, that we think has many of the same attributes and is desirable. People want to live there; there's breadth of employment; there's a healthy economy; and there's some sort of a disconnect between that market with certain level of pricing, and another market that we think is pretty much the same, with this level of pricing. We think these markets can shift pretty quickly once they're discovered.

We also think factors like rent growth can change pretty quickly. I'll give you an example of that: in our market in San Diego, very little has been built since 2007. If you look at building permits that are being generated now, they're very, very low – virtually none. So very little is likely to be built. If a permit is approved on January 1, 2011, you're really not going to have supply in the marketplace much before the middle of 2012 or the end of 2012, if things go well and there aren't a lot of hiccups along the way. So from 2007 to 2012, very little new supply is going to be created in this market. Yet, year in, year out, tens of thousands of people come here. People and companies are creating jobs and a strong university system. Folks retire to the great weather in San Diego. We know that you're not going to have an environment with no rent growth forever, and while we might underwrite, little to no rent growth in 2010 and 2011, you're going to get a spring effect where, at some point, rents might pop – not one or two percent, but eight or ten percent. I'm not saying that's going to happen here, but that's the sort of "looking to where the puck might be going" theory that we try to employ.

Craig: So you see opportunities today that you're dealing with, buying properties that are distressed, or buying distressed loans that you can

own at some point in time, and that's what's happening today. Where's the puck going tomorrow? Where do you see the opportunities for tomorrow?

Mitch: Good question. We think this cycle is going to be characterized by waves of distress. So the first wave we saw beginning to crest in 2006 and 2007, and that was the subprime, single family residential wave. That was then followed by some of these commercial loans that hit maturity default: the CMBS securitized loans that simply matured, the financial institutions that held them, and the trusts that held the CMBS paper didn't have a really good mechanism to refinance those loans. The market had changed, such that the loan that was entered into in 2005, that might have been an 80% loan to value situation, based on a value up here, is now a value down at this level with a 60% loan to value equation, and you're staring at a borrower who, to refinance, would have to write a multi-million dollar check. He doesn't have it, and he doesn't want to do it.

So that's another wave of distress, and that got dealt with by the banks with pretend and extend. I think another wave that we might see is a dramatic shift in consumer spending, which we are seeing. We're seeing more savings, less spending. We've seen a period of time from about 2000 to now, where all the big retailers – Target, Best Buy, Home Depot, Lowe's – all these guys increased their store counts at huge levels. And their sales didn't keep up with the percentage growth in store count, and their profits didn't come close to keeping up with that. We're over-stored, and not only are we unlikely to have store openings, we might have a long period of time where we have store closings. That has implications for the value of these properties and of consumer spending. Consumers don't have the income; if unemployment stays high for a long period of time and savings rates stay high or increase, you may be staring at a situation where a lot of strip retail centers are obsolete and don't have any value.

Think Vegas, think Florida, the Inland Empire, and some of these markets where they were built for this new subdivision for 50,000 people that is half-sold. It's a disaster. So that is likely to be another wave of distress. Hotels were another wave of distress that we saw pretty early.

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Craig: That being said, what should investors be doing today to set themselves up for success at getting these opportunities for tomorrow?

Mitch: What we are doing is indicative of what one should do. We're built, at Pathfinder, to evolve with the market. We don't have any preconceived notions about what the right asset type is. We're somewhat flexible as to geography. We're somewhat flexible as to deal size. We can buy loans as well as assets. We've had a good run with the residential and multifamily assets the last several years, but we have no illusions that it's going to last forever. We think we have a team that's got a broad-based set of skills in evaluating and underwriting and valuing different types of real estate in different market areas, so if the returns appear to be compelling in 2012 for suburban office (which I don't expect), we think we can migrate to that kind of a product type. We're finding opportunities across asset types, across geographies, by having a slightly different strategy.

Craig: Pathfinder looks at a lot of deals and only invests in a few. What are 3 or 4 critical things a deal must have?

Mitch: First and foremost, a deal needs to have a motivated seller. If you've got a bank that's simply a tire-kicker, that's trying to put something out to market and have a whole bunch of people bid on it just so they can learn what the market thinks it's worth, but isn't really a serious seller, we're not going to spend a lot of time on that deal in the first place. If we don't spend a lot of time on it, we're probably not going to do it.

It should also have an opportunity for us to conclude that we can add some value. Again, there should be a catalyst for us to add value; either a mandate on the part of the bank, its board, or its regulators to sell by a date certain at a price that makes sense; opportunity to add value through pursuing the loan-to-own strategy; opportunity to add value through completing construction or leasing it up; or doing something else.

If you come to us with an institutional-size listed deal in a top-tier market, on a trophy property that's 98% occupied, we're probably not

going to spend five seconds on it because we know every REIT and his brother is going to be lining up around the block to buy it.

Craig: On a smaller scale, Pathfinder purchased the Isis Condominiums, a 41-unit, new REO condo project in Orlando, which includes 6,500 square feet of retail space. Tell us about this deal and value.

Mitch: It's in a new master planned community called Winter Springs, which is a suburb of Orlando. It's a brand new product that was conceived to sell for about $375,000 a unit. The market collapsed, there was no for-sale market, but we knew that the price to replicate this product was probably double what we paid for it on a per-square-foot or per-unit basis. So we were very happy to own it at that price. We think we can reset the cost basis, and we can either sell condominiums next year, into 2012, and call it half of the old price and make a nice return or hold it as a rental; it's currently 100% occupied.

We have a cap rate for this asset that is dramatically superior to the cap rate of comparable properties, and we have additional upside. We're getting nice cash-on-cash returns while we wait, with the prospect that we can have a very healthy pop by selling it either as a stabilized multifamily community or selling individual condos. So we have dual exit strategy, and that's also something we see on many of our deals. We look for that. We look for opportunities to have multiple ways to get out.

Craig: As you reposition and renovate your new property acquisitions, what unique strategies do you use on the properties to create more value?

Mitch: There are a lot of groups that are particularly astute at buying something that's under-managed, tweaking it, adding a little bit of value, or employing debt leverage – low-cost debt leverage, and sort of nibbling around the edges, but earning an attractive return by holding an asset for a long period of time, or managing it better than the last guy. I think that sort of incremental approach, that's not really where we're coming from in this cycle. We're doing dramatic things.

There are many people out there that are better nuts and bolts operators than us, I'm sure. We're good; we're reasonable; but we

are transforming assets. We're coming in, and we're taking a stalled project. For example, a prototype of the deal that we would do is the acquisition of the loan with a recalcitrant borrower, where construction remains, the building's empty, there's no certificates of occupancy; you have to complete the condo map, get it leased up, stabilize it for a year or two, and then sell it for a profit. And we probably have to do that deal in two weeks and close on an all-cash basis. So that's a combination of factors. So we're adding a lot of value very, very quickly in the process. Within the first year, we've taken the loan on the empty building, and turned it into fee ownership of a finished, fully-occupied kind of a project, and as a result, when we're able to do that, we've created a lot of value, and we've positioned ourselves for a relatively quick turn and redeployment of our capital.

I don't know that that's going to be what characterizes this cycle over the next three to five years. Maybe the next wave of distress is going to be more about the capital markets and more about when financing returns to the capital markets. Or it might mean that we have five to seven-year holding periods instead of two or three, which is what we've seen in the last several years. So we're somewhat uncertain about what the next opportunity is, but there will be opportunities.

Craig: What are some key things that you do that makes you different and why you're so good at what you do?

Mitch: We have a diversified team of people. My partners include – I'm a former corporate CEO. I was an investment banker in venture capital. I've done a lot of workout and restructuring work, bankruptcy work, public and private finance and so forth.

We've got a 20-plus year commercial real estate attorney on the team who's very experienced with foreclosure. He's one of the nation's recognized experts in condominium law and condominium conversions and new condo construction; he has a lot of bankruptcy law experience as well.

We have a couple of seasoned, 20+ year real estate analysts who have, combined, sold, purchased, invested in $8+ billion worth of real estate, including a lot of multifamily, office, hotel, retail – all the food groups.

We've got a CFO who's a former public company chief financial officer. So we have a fairly broad range of talent and a pretty deep bench, and we're able to come in and throw that skill set against a deal and underwrite it very quickly. Combine that with our discretionary capital and our track record, and really resonate with a selling financial institution that maybe has been burned once or twice with other, lesser groups that didn't perform. And you do that enough times, and the banks start calling you back on the second and the third deal.

Craig: It sounds like you can do a lot of deals other people can't do, just because of your expertise. Would you think that's fair?

Mitch: That's fair. We're also willing to do deals that other people "won't" do, in particular, smaller deals. Again, a lot of the institutions fade away when you're looking at a $6 or an $8 million deal because it's just too small to move the needle. A lot of REIT's don't want to buy loans. They want to buy real estate. A lot of people aren't willing to complete construction and so forth. When everybody zigs, we try to zag. We look for these things that have hair on them and that we think are likely to scare others away, because we are, quite candidly, tired of going through auction processes and being one of 30 people bidding on stuff. That's just not interesting for us.

Craig: What's your forecast for 2011? How do you see it playing out?

Mitch: The market has been buoyed by low interest rates and available credit, and it's considerably healthier today than I think we would have expected it would have been, had you asked me that question a year ago. But we think there are a lot of rocks in the water, and we think there are more icebergs out there to navigate around that perhaps are not as apparent to everyone.

Folks are fairly buoyant and they're optimistic, and some of that optimism is warranted, but as we saw in the spring of '09, the 100 or 150 basis point spreads that we're seeing today between BAA corporates and the 30-year treasury bond, they can blow out to five or six hundred in no time. And it wouldn't take much for that to happen.

We're seeing a lot of stimulus, a lot of this quantitative easing, and it's

not moving the needle on unemployment; it's not really changing the game on consumer spending; and things are not as stable, perhaps, as they appear to be. And I would argue that you've got to have a pretty bullish view about inflation to be a buyer of real estate assets at four cap rates in the current environment. And I appreciate that interest rates are really low, but we don't get that. We think there are still some disconnects in the market.

There's still a situation where you mentioned second-tier markets, tertiary markets, and you've got a situation where primary market assets are selling at four caps, and secondary and tertiary market assets aren't selling at all, or are selling at eight caps. Something's got to give. Right? It's too big a delta. Whether the broad market remains kind of steady, as it is now, whether it gets healthier, or whether it falls off a cliff – which we don't expect – we do believe that many of the long-term trends that have been building, that have caused this distress – the poor underwriting standards, the lack of a securitization market, the dearth of buyers who can get financing – those aren't going away.

More banks have been seized in the first 10½ months of 2010 than were seized all last year. We think there'll be hundreds of banks seized per year for each of the next several years. Those assets have to go somewhere. Those assets are getting plugged into successor banks, in some cases; some of them get held and worked out; some of them get foreclosed on and sold; and to a lesser extent, those loans get sold or worked out. That is pressure that's going to continue. There will be more supply. There's been very, very little supply the last few years. That's been part of this problem. The banks have kicked the can down the road and haven't foreclosed, and there's been no supply, and there's, meanwhile, a lot of money on the sidelines. We think supply increases and more of that money gets put to work.

I hope you enjoyed this interview. For more information on Mitch Siegler and Pathfinder Partners, please call them at 800-494-8211 or visit their website at www.PathfinderPartnersLLC.com.