

INSIDE THE DEAL: Pathfinder Project Illustrates Vagaries of Distress

By **Natalie Dolce**
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When it comes to maneuvering through the ever-changing world of distress, persistence pays. Take San Diego-based Pathfinder Partners, which recently brought back onto the market a long-stalled 68,000-square-foot office and medical condominium. The project—which consists of 10 suites ranging from 5,200 to 10,700 square feet on 4.2 acres—is called Eastlake Professional Center and comprises six buildings in Chula Vista's Eastlake area in San Diego.

Pathfinder, which was formed in July 2006 to specialize in distressed and opportunistic investments, bought the property at a foreclosure sale. But, as in many distress deals these days, getting the property wasn't simple.

"Sales at the property, which received its certificate of occupancy in 2008, had been stalled for several years," says Mitch Siegler, senior managing director of Pathfinder Partners. Siegler tells DAI that the original borrower defaulted on a \$16.3-million loan and was embroiled in litigation with the lender, preventing the sale of any condos.

Yet another obstacle standing in the way, Siegler points out, is that the company was trying to acquire the loan from a bank "that was very weak." He explains that "because it was a 'sick' bank, it couldn't sell anything because any asset it sold would generate a further loss, which would further weaken its capital structure."

Siegler adds that the bank was in a debt spiral. "It just couldn't do anything," he says, "and it was eventually seized by the FDIC." Although Siegler could not disclose the bank's identity, public documents list Vineyard Bank NA as the beneficiary.

The successor institution, "a much healthier bank," according to Siegler, owned this asset pursuant to the FDIC law share arrangement, so Pathfinder followed the special-assets officer over from the "weak" bank to the "healthy" one, he explains, and picked up the conversations about buying

the note. But as it turned out, the bank didn't want to sell. Public records show that the "much healthier bank" is California Bank & Trust.

Siegler figures the bank didn't want to sell the note because "generally they can realize more value by going through the foreclosure process and selling real estate in an orderly fashion. There are many reasons why institutions sell notes, but this was one where they found a happy medium. They didn't sell the note, but they also didn't foreclose and end up with the property and those other overhanging issues. They were fortunate enough that someone bought the property at the foreclosure sale."

Although Siegler couldn't confirm the original borrower's identity, DAI learned that Urban+West, a Santa Ana, CA-based developer in partnership with the San Diego Smart Growth Fund—with capital from CalPERS and from banks and insurance companies—acquired the parcel in 2006.

Siegler says that the originating bank was engaged in litigation with the borrower. "There were all sorts of claims," he says. "The borrower claimed that people wanted to buy condo units in 2008 and the bank refused to allow sales to go through, and I'm sure the bank claimed that the borrower defaulted on the note. It was messy." So, part of the discussions between Pathfinder and the bank, he says, was that Pathfinder would continue the litigation with the borrower so the bank could extricate itself.

Ultimately, Pathfinder's persistence paid off when it prevailed at the foreclosure sale, acquiring the property and later naming commercial brokerage firm Cassidy Turley BRE Commercial as the listing agent. The project, which was originally called Eastlake Medical and Professional Center before Pathfinder renamed it Eastlake Professional Center, was conceived to sell for prices in excess of \$300 per square foot. Siegler points out that instead, Pathfinder paid around \$75 per square foot. Public records show that Pathfinder purchased the property for a penny more than \$4.6 million.

"So, we've reconstituted the cost basis to sell units profitably in the mid-\$100 to mid-\$150 per square foot range," Siegler says. "We got it for half of the old price."

Siegler also points out that the project, although it was in financial distress, benefits from an excellent location and building features. It is centrally located in the heart of the Eastlake and Otay Ranch commercial districts, directly off the new South Bay Expressway (Route 125), approximately 15 miles south of downtown San Diego. The buildings have ceiling heights ranging from 10.5 feet to 12 feet, extensive window areas and brushed aluminum door frames. Each building comes fully equipped with air conditioning, electric and water meters and telephone/Internet lines. The property also contains extensive parking.

Pathfinder's investment philosophy when acquiring real estate assets is that it considers supply and demand; general economic conditions; and market dynamics, including occupancy trends and concessions. Of course, it also considers population trends and cost basis—relative to comparable properties and replacement cost.

Pathfinder manages several funds that own and invest in diversified portfolios of commercial real estate assets, composed primarily of well-located, income-producing properties such as multifamily, office, industrial and retail, or debt securities underlying such projects. Pathfinder Partners Opportunity Fund I LLC was formed in August, 2007 and acquired distressed real estate investments through March 2010. Pathfinder Partners Opportunity Fund II LP had its initial closing in May 2009, and Fund II and a parallel fund have been acquiring distress since then.

To date, Pathfinder has acquired approximately \$300 million in face value of distressed notes and bank-owned properties.