Close-up: Mitch Seigler

Pathfinder invests in distressed multi-family properties

By JEN LEBRON KUHNEY
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Seigler

San Diego-based **Pathfinder Partners LLC** is taking Warren Buffet's advice: Be fearful when others are greedy, and be greedy when others are fearful.

Well, maybe not "greedy" per se, said Mitch Seigler, a co-founder of Pathfinder who describes his company as an "opportunity fund."

Pathfinder was started in late 2005 when Seigler and his partner Lorne Polger, a former real estate attorney, realized the commercial and residential real estate market was headed for disaster.

"People were getting loans they couldn't afford," he said. "Nothing down and liar's loans inundated the market. ... On the commercial side, companies were getting $50 million to $75 million deals done with a few hundred thousand dollars' worth of borrowed equity thrown into the deal."

Seigler described loans that were pieced together like Frankenstein's monster.

"You had an 80 percent senior loan and a 15 percent (mezzanine) piece and another 4 percent junior (mezzanine) piece — it created an environment like the one you see in the residential market right now. ... People were willing to walk away."

He and Polger had been friends for more than 20 years, with Polger serving as Seigler's corporate attorney. They saw opportunity to purchase residential and commercial real estate at a big discount, while helping lenders unload unwanted properties.

In 2006, Seigler and Polger started calling banks only to be "met with a bucket of cold water."

Unlike Seigler and Polger, they didn't see the need to get the multi-family properties off their hands.

By 2007, some forward- thinking banks started realizing there were problems, and last year Seigler said more than 800 loans crossed their desks — but they only picked up two of them.

"There became a realization this wasn't going to correct itself anytime soon," Seigler said.

But even now, it's not always easy to get the loans on the properties Pathfinder wants.

"We joke the banks are drinking out of a fire hose," he said. "They're focused on the most serious problems in the here and now — the stuff that's coming crashing on their heads today. If you talk to them about a project that's just now coming into default or a guy's missed his first or second payment, they don't even want to talk about that."

Rather than focusing on single-family homes or commercial spaces, Seigler and Polger decided to pursue multi-family deals, viewing them as one of the most stable areas of real estate.

"Office buildings are subject to lots of vagaries within the market: jobs, telecommuting, the overall economy. Certainly you could say the same thing about retail and hospitality," he said. "But with multi-family, people will always need a place to live."

But unlike other companies that want "turn key" properties in top physical shape, Seigler said Pathfinder looks for ones that are less than perfect.

The first loans the company bought were for a couple of "broken" condominium complexes in south Florida in late 2006 or early 2007.

At that point, the West Coast market hadn't recognizably fallen, but Seigler said he and Polger got the properties at a heavy discount.

One was sold back to the second mortgage holder, but the other went into foreclosure, leaving Pathfinder free to fix it up and turn it into apartments.

Since then the partners have purchased three more investments, including a condominium complex called Mer Soleil in Chula Vista.

While that may not sound like much, the properties are worth millions, and have the potential for a high return.

"It's not this game of musical chairs where we're going to make our money by upping the price and selling to the next highest bidder," Seigler said.

He said Pathfinder is willing to hold on to properties, fix them up, rent them out and then sell them at a later date. It's what Seigler describes as a "back-to-basics" model.

The company pays for properties in cash and is willing to hold properties for three to five years.

However, once Pathfinder stabilizes the property through foreclosure or other means, it takes out an equity loan on the property to regain some of its capital.

"We have a capital structure that's low enough on debt that allows us to ride things out as a rental property for several years before selling it and obtaining a capital gain on the property," he said.

With the Chula Vista property, Pathfinder has been able to sell about 50 percent of the units while leasing others. Unlike the original owner of the property, Pathfinder was able to sell the units at a lower price, since it did not have to absorb the typical costs of selling brand-new units.

The original owners were trying to sell at $325,000 to $350,000, but Pathfinder has been selling units from $240,000 to $250,000.

Before considering an individual property, Pathfinder determines if it is located in a market with potential for growth and positive market dynamics. Places like California, Florida, Texas and Arizona are the areas most appealing to Pathfinder.

Additionally, the company looks at other factors, such as number of building permits pulled, that could positively affect the market.

California, for example, has seen record-low levels of residential building so far in 2009. While it may be due to a slow housing market at the present, Seigler said in a few years there will be pent-up demand for multi-family.

Next, they look at when the original loan was made. If it was made toward the peak of the market, Pathfinder can expect a "discount." If the loan was made before 2003, they do not have much of an opportunity to foreclose on the property and become the new owners.

However, for loans made after 2005, the current owner could be underwater or delinquent, creating a need for the lending bank to get rid of it and into the hands of Pathfinder.

Seigler said Pathfinder plans on holding properties it forecloses on for several years.

When the market improves in a few years, the company can cash in on everyone else being greedy.

But will Pathfinder become fearful? No, Seigler said.

"Our view is there are waves of distress coming," he said, "and this could be a cycle that continues unfortunately for many years. And it will probably ripple through various regions of the country and various types of real estate."

"There's going to be opportunity for quite a few years to come."

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