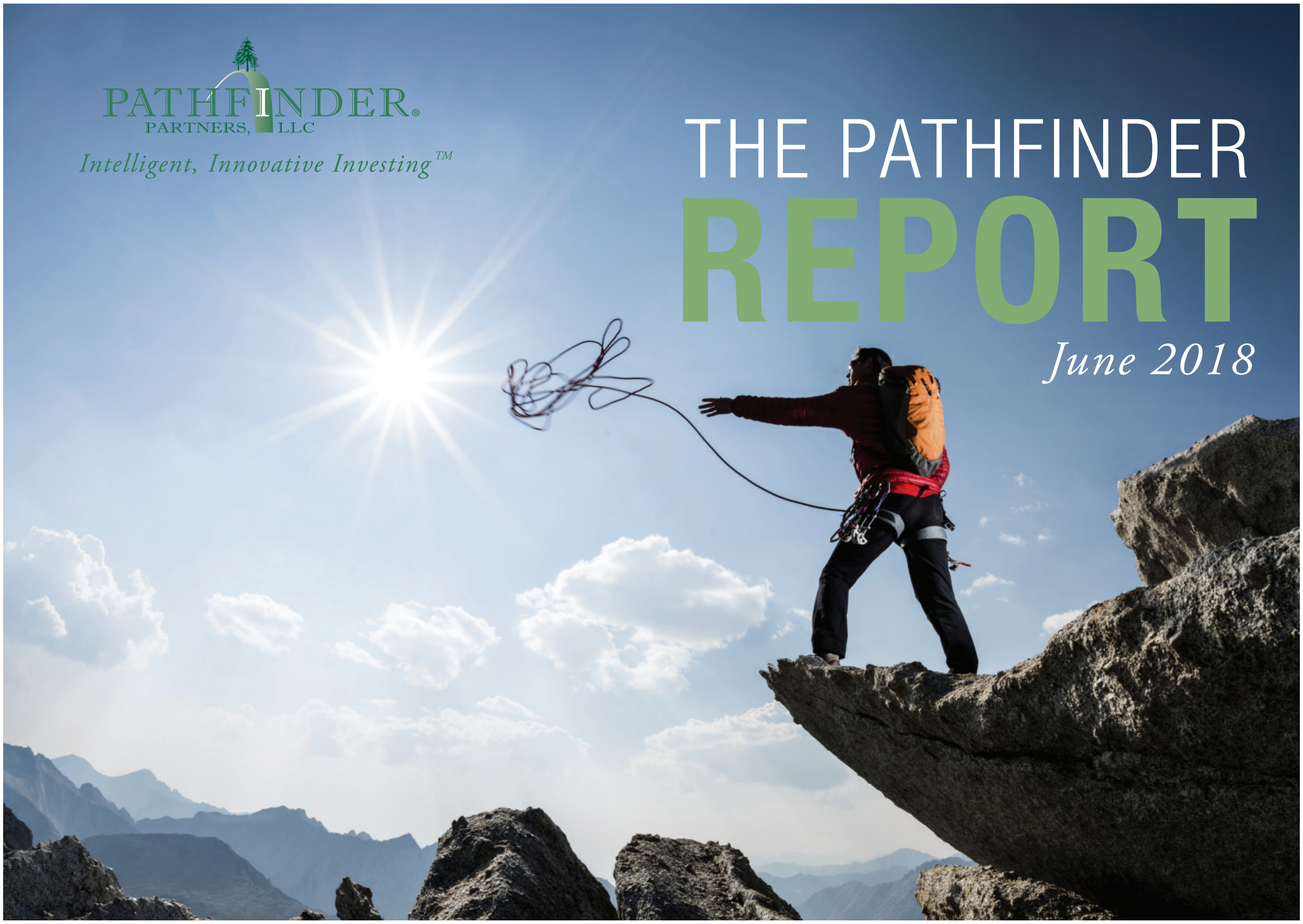


THE PATHFINDER REPORT

June 2018

IN THIS ISSUE

The initial closing of Pathfinder Partners Opportunity Fund VII, L.P. (the "Fund") was held March 31, 2018 with $34,000,000 in commitments. The Fund will remain open until December 2018.

CHARTING THE COURSE

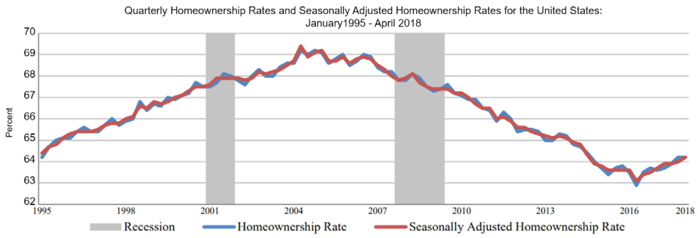
What's With Our Kids? Millennials Delaying Marriage, Family and Home Ownership

By Mitch Siegler, Senior Managing Director

My wife and I were 28 when we married 30 years ago. We had our son seven years later (at 35) and our daughter five years after that (at 40). We were outliers – our peers married several years earlier and had kids sooner. But our experience is closer to today's reality, though marriage is further delayed. The average age of first marriage in the U.S. is now 27 for women, up from 23 in 1990 and 23 in 1960. Men married at about two years older across the board.

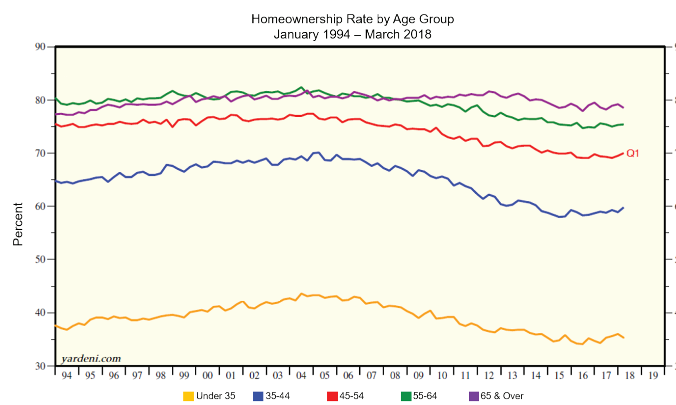
For more than a decade, the U.S. has been going through a period of extremely low household formation and rapidly declining homeownership. We're about to throw some numbers at you; hang on tight because it will all make sense and fit with what you're hearing from your kids and reading in the news. We'll then stitch it all together with some mega-trends – things we hope you'll be able to use to make more effective business and investment decisions.

New household formation, depressed since the Great Recession, is expected to begin slowly increasing, aggregating 12 million net new households over the next decade. The 20 million new Millennial households (those born in the '80s and '90s) will be offset by eight million fewer Baby Boomer households (those born in the early '40s to the mid '60s). Millennials now number 75.4 million, surpassing the 74.9 million Baby Boomers. Homeownership, meanwhile, which peaked at above 69% in 2004, has fallen to 63% today and is projected to fall below 61% by 2025.



Source: U.S. Census Bureau, Current Population Survey/Housing Vacancy Survey, April 26, 2018, Recession data: National Bureau of Economic Research, <www.nber.org>

Just 13% of 20-year-olds head a household today, compared with 63% of 30-year-olds and 76% of 36-year-olds. You can basically chart household formation by adding five percentage points per year during a person's 20s. Homeownership also rises rapidly during one's 20s but it starts at just 8% for 20-year-olds and rises at only a 3% annual clip – by age 30, 38% of people own a home, growing to 52% at age 36 (in 2006, 50% were homeowners at age 31, five years earlier).



Source: U.S. Census Bureau – www.yardeni.com

Millennials, unlike previous generations, are renting first, then buying homes later – and later in life than prior generations. Specifically, young adults today are marrying four years later than their parents and six years later than their grandparents, on average. Millennials value mobility and will move across country for the right job. Home ownership can keep you locked in and Millennials are renting apartments for flexibility. The proof is in the pudding: apartment occupancy rates are 95%+, full capacity, in virtually all of Pathfinder's western U.S. markets). At the same time, there's exceptionally strong demand for rental homes. All of this goes a long way to explaining why Millennials have a 35-40% homeownership rate, compared with 75-80% for Baby Boomers.

Let's peel back the onion to understand the "why?". Basically, each generation is a product of its times, defined by the key events which shaped people at key stages of life. Think WWII, the Vietnam War, the protest and civil rights movements, the Cold War, the Great Recession, etc.

Baby Boomers are children of the WWII generation. Fathers were "organization men", often characterized as workaholics. Mothers were the first generation to join the workforce, en masse. With both parents at work, many kids were on their own after school and families struggled to find a work/life balance. Many homes were in the suburbs and some parents spent hours commuting, on top of a long workday. Weekends were spent mowing lawns and doing household chores – ah, the joys of homeownership!

During the '70s, '80s and '90s, attitudes toward work, work/life balance and families began to change with millions migrating from New York and other old-line cities in the northeast to less crowded areas with better weather – like North Carolina and other states on the Atlantic seaboard; Texas, Georgia and other southern states; and Arizona, California and other western states. Many of these areas are more affordable and quite a few have lower tax rates (California being a notable exception on both counts). Meanwhile, employment shifted from IBM and other Fortune 100 companies where the ethos had been "lifetime employment" to start-up companies (some of which grew into behemoths like Microsoft and some went bust) but all of which valued informal attire, flexibility and more time off for family. These trends have accelerated in today's tech era, epitomized by employers like Apple, Facebook and Google.

So, how do these factors affect attitudes about homeownership? Well, back in the day, owning a home was "the American Dream". Owning a home was considered the best investment one would ever make. Many Millennials watched their parents working long hours and spending more time commuting in traffic just to get back to the home in the suburbs so they could spend their weekends puttering around the house. For a generation that values mobility and experiences (travel, concerts, restaurants and bars), being tethered to a mortgage doesn't have the same appeal. And, overlaying the fact that they're waiting longer to marry and a home in the 'burbs makes far less sense. For those who watched their parents and family friends experience the agony of foreclosure and those choking on some of that $1.5 trillion of student loan debt, *fuggedaboudit.*

Ten trends that could transform Millennials' lives

The ten emerging trends below could impact Millennials' lives and have important implications for homebuilders and apartment owners and impact diverse industries, including travel, transportation, financial services and healthcare:

1. Better educated people with higher levels of student loan debt – Young people, better educated than ever, are accessing high-paying, technology-based jobs. Many recent grads are choking on their piece of the $1.5 trillion in student loan debt. That monthly debt service is money they don't have for a down payment on a home.

2. We have bills today that didn't exist a generation ago – In addition to hefty student loan payments, bills for cable TV, cell phones and gym membership are *de rigueur*. These services have arguably improved (well, at least changed) our lives but they also leave less disposable income for other things, including down payments.

3. Gimme "spare time" – The hippest tech companies have lunchrooms with menus designed by renowned chefs, dry cleaning pick-up/delivery, shuttle buses and other time-savers – why leave campus? Higher income households – those with the top 20% of incomes (call them "busy") now spend 51% of their household food budget at restaurants/take-out and just 49% for groceries/home cooking. That trend is accelerating, driven by Amazon's acquisition of Whole Foods, DoorDash, Postmates and the like.

4. Millennials will seek to remain mobile – California college graduates relocate to Seattle, Portland, Denver, Austin or Nashville for good jobs and the hip and cool lifestyle these cities provide. Bostonians relocate to San Francisco or L.A. to break into a top technology company or the entertainment industry. Lower cost environs like Texas, Nevada and Arizona are attractive to many young people. If you want to know your grandchildren, prepare to travel.

5. Why own? Let's just rent (everything) – Lots of ways to tell this tale but here's one that drives it home quickly: the proportion of teens with driver's licenses has fallen 47% since 1983 (from 46.2% to 24.5%, according to *The Atlantic*). This trend that will have profound implications for car manufacturers, public transit authorities, Uber and Lyft. Shifting back to housing, Millennials who relocate will rent until they settle in and settle down. The money they save on homeownership (especially in high cost locales like California), is spent on experiences or used to pay down student loans rather than immediately saved for a down payment.

6. Housing shortage means even higher home prices and rents – We've been seeing this for years, brought on by a severe housing shortage (dubbed a housing "crisis" in California). Insufficient buildable land, impediments to securing entitlements, community opposition to development and rising construction costs have created more demand than supply and home prices and rents have been escalating. While those increases are likely to moderate, you can't turn around an ocean liner quickly.

7. Rising interest rates and rapid home price appreciation – The Fed is expected to raise interest rates twice more in 2018 and twice more in 2019. Higher mortgage rates will lessen affordability. That's on top of robust home price appreciation across the country for several years running. This will further crimp demand for new homes and keep apartment occupancies high.

8. Massive generational wealth transfer – The silver lining on the above, for some, is that the student loan debt could be overcome and the down payment managed through help from parents. As the Baby Boomers age and pass on, the largest wealth transfer ever is likely to occur.

9. Longer lives – Medical advances, driven by genomics and personalized medicine are increasing life expectancies, increasing the number of older people and draining pension funds with defined benefit obligations. While it's not unusual for young people to consume what they earn rather than save for retirement, the combination of Millennial attitudes, longer lifespans and rising rates could foreshadow retirement challenges for this generation down the road.

10. New industries, new opportunities – The pace of change continues to accelerate and the Millennial generation will have career opportunities that were unimaginable a short time ago. The best and brightest in 2018 can explore opportunities in fields as diverse as virtual reality, artificial intelligence, renewable and green energy, alternative protein foods, cannabis and content marketing. Millennials: the world really is your oyster.

[Editor's Note: Thanks to Chris Porter, Chief Demographer at John Burns Real Estate Consulting, who provided insight for this article. For more information on this subject, check out "Big Shifts Ahead: Demographic Clarity for Business" by John Burns and Chris Porter.]

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 an investment banking and venture capital firm. Reach him at msiegler@pathfinderfunds.com.

FINDING YOUR PATH

A Modern Dictionary

By Lorne Polger, Senior Managing Director

I've been in the real estate business for about 30 years and have developed a good handle on the industry's vocabulary. Even after a glass or two of wine, I can hold my own at a real estate industry cocktail party or conference.

Now, when I'm hanging out with Millennials, technology folks, or heaven forbid, Millennial techno geeks, I have a first-grade comprehension level. Since I'm slow to catch on, I spent some time getting caught up. After extensive research, here's my list of top new phrases in those worlds.

Millennialspeak:

Fam – A person's group of friends and/or family. Example: "What up, fam?"

Hundo P – Literally short (but actually longer) for 100%. Used to describe something that's really awesome, or totally certain. Example: "Hundo P, we're fully invested in Pathfinder Fund VII by the end of 2019."

Lit – Something that is hot and happening. Similar to "cool," but with an added emphasis on the fact that it's fresh and current. Example: "Mitch's party last weekend was totally lit, why weren't you there?"

Low Key – Something you need to say or express but would prefer if nobody else knew about it. Kind of like asking someone to keep something "on the down low," in that you don't want them to tell anyone about it. Example: "Low key, Brent told me he's getting the Tesla SUV tomorrow."

Salty – No, not like the anchovies on your Caesar salad; used to describe someone who is angry or bitter. Example: "I'm salty, the Padres got shut out again last night."

Squad – Your closest group of friends. It's kind of like "fam" but more focused on just the very most trusted of your friend group. Example: "I was at the big real estate conference last week with Scot and the rest of the squad."

Woke – "Woke" means you're knowledgeable, aware, and "with it." It's the opposite of ignorance, and is usually used as such. Example: "If you care more about the Kardashians than the affordable housing crisis, you need to get woke."

Techspeak:

Big Data – Collections of data from mobile devices, emails and databases that are so large they can't be processed through traditional processing systems. By combing through this data, companies can identify consumer patterns and use them to predict and optimize their business. For example, Big Data has told us that six out of ten residents in our Seattle area properties prefer rain to sun.

Cloud Computing – Data is not stored on your own computer, but instead spread out among remote servers accessible through the Internet. Services like Google Docs, Facebook and Gmail are examples of cloud computing – you are interacting with data on your home computer that is stored in "the cloud." Most of Pathfinder's data is similarly stored in the cloud. I've always wondered what would happen if the clouds make way for sunshine, or if there is ever a thunderstorm. That's probably why I've stuck to real estate instead of technology.

Multichannel Marketing – Multichannel marketing uses a variety of communication platforms (website banner ads, Facebook ads, marketing emails, a blog) to interact with potential customers. This approach allows users to choose which channel they want to use to interact with your product and increases options for converting impressions into customers, or in our case, tenants and homebuyers.

Organic – No, not the end caps at Whole Foods. Organic describes social media content that ranks highly because individual users have liked, reposted, or viewed it – not because companies have paid to promote the content. At Pathfinder, we try to use organic content in our social media postings as a continuing brand-building exercise.

Responsive Web Design – Responsive web design is the practice of designing websites so that they adapt to different-sized devices like phones, tablets, wearable devices, etc. If you're able to visit a website on your phone and it looks just as proportional and seamless as it does on your computer, the website was "responsively" designed. At Pathfinder, we work with our web designers to ensure that when prospective residents search online for their next apartment, our pages are seamless and professional irrespective of devices used.

Fortunately, the lexicon in the real estate world has remained fairly stable over the last couple of decades. That said, there have been a few changes. To better assist your summer cocktail party chatter, here's a short list of modern interpretations of real estate buzz words.

Adaptive Reuse – As in, "Heh, did you know we just turned a sausage factory into a cool office/commercial center?" (May not get more adaptive than that unless you turn a shopping center into a sausage factory, if you're so inclined.)

Break-Even – Not exactly a four-letter word but very bad nonetheless and you shouldn't teach this to your children.

Capital Expenses or "Cap Ex" Improvements – As in what you spend to make old stuff look new again.

Common Areas – Where most people hang out when they are not in their homes. As in "The new dog washing station in the clubhouse *common area* is sick." (Okay, I threw in a little Millennialspeak there…)

Comp Set or Competitive Set – As in when you walk around a neighborhood and turn your nose up at all the other building that you think aren't as pretty as yours. As in, "I toured the *comp* set, I think we've got the belle of the ball."

Concessions – What you give up in free rent to get a lease signed. A very, very bad word in the apartment business. Worse than Break-Even. Think Lord Voldemort bad.

Debt Coverage Ratio – As in, when the cash flow covers the mortgage! Not a problem in the apartment world these days.

Delivered – A building whose construction is complete (i.e. obtained its certificate of occupancy or COO). With a COO, the property will be considered delivered whether or not tenants have occupied the space. As in, "Phew, we *delivered* that one on time and on budget!"

Functionally Obsolete – A descriptive term used to characterize a building that cannot be improved to meet current market standards or tastes. As in, "I knew that shuffleboard amenity was *functionally obsolete*. We should put an Uber pick-up spot there."

Leasing Activity – What I ask our property managers about every evening. As in, "Heh guys, how was our *leasing activity* today?" Neither "none" nor "slow" are answers that put a smile on my face.

Letter of Intent or LOI – The document drafted before the Purchase and Sale Agreement that is hated by lawyers because it usually doesn't contain enough legalese.

Loan to value – Expressed as a ratio – the borrower always thinks it should be lower and the banker always thinks it ought to be higher.

Opportunistic Investment – As in, when you see something that no one else sees. Which sometimes make you wonder, are you really seeing it?

Repositioning – As in, the building is in horrible condition, but with our extraordinary vision and skill – and a boatload of money – we can make it nice again.

Speculative or Spec – A building developed and constructed without any preleasing in place. As in when most of the new construction in town is *spec*, it's time to sell everything!

Sponsor – The guy that signs the bank loan. As in, "Bob's the *sponsor* on the deal, I hope he can sleep at night."

Transit-oriented Development (TOD) – Used to be, something pretty close to a bus or light rail in. Now, as in, "Dude, Uber will get here in two minutes." (Oops, there I go again.)

Under Renovation – As in the building is a complete mess, and there are 18 guys with pick-up trucks parked outside at 7 a.m. Typical Pathfinder use: "We may be offering some minor concessions while the building is *under renovation*."

Underwriting – An industry term referring to financially analyzing a prospective investment. As in, what Scot and Brent do at Pathfinder when they are not watching Wisconsin football and basketball games.

Value-Add Investment – An investment in a real estate asset with existing cash flow (and value) that can be increased by raising occupancy, rents or both. As in, "Heh Mitch, that 150-unit deal in Phoenix is a great *value-add investment*."

I hope you're feeling a little more informed now and that your summer social calendar will allow you to implement your newly expanded vocabulary.

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. Reach him at lpolger@pathfinderfunds.com.

ZEITGEIST – SIGN OF THE TIMES

West Coast Construction Costs Soar

Construction costs continue to rise and the major west coast markets are bearing the brunt of the pain. According to a recent report by *Rider Levett Bucknell*, a leading independent construction consulting firm, the average increase in construction costs was 4.2% in 2017. Los Angeles had the highest increase at 7.6%, followed by San Francisco at 6.3% and Portland at 6.0%. Seattle followed at 5.1%. For perspective, if an L.A. developer prepared a cost analysis in 2016 with a plan to commence construction in late 2017, the project, originally contemplated at $20 million, would cost $1.5 million more than anticipated before they swung the first hammer.

The chart below outlines the year-over-year price increases of five key commodities for the construction of apartment buildings, according to February 2018 data provided by the *Bureau of Labor Statistics*.

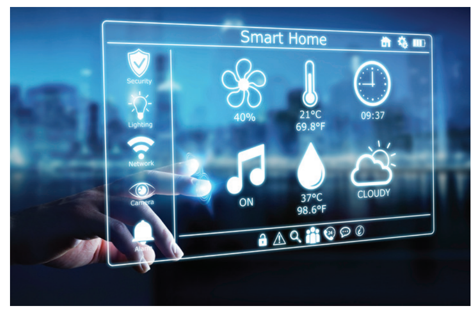
Commodity	12-Month Change
Soft plywood products	29.1%
Softwood lumber	16.3%
Power wire and cable	14.7%
Copper wire and cable	9.9%
Gypsum products	8.4%

Ken Simonson, Chief Economist with the *Associated General Contractors of America*, expects "contractors to pay 4-5% more (for construction materials and services) in 2018 than in 2017." Simonson expects "direct labor costs for wages, salaries and benefits to rise 3-4%." These substantial increases in material and labor costs continue to make it challenging to economically construct new housing.

[Editor's Note: Pathfinder believes these anticipated increases make purchasing and rehabilitating existing multifamily properties a good alternative for investors looking to hedge rising construction costs.]

Smart Home Technology on the Rise

Technology changes quickly these days – flip phones are now a retro relic of our smartphones and CD players are just plain embarrassing. These innovations typically are adopted gradually and quickly become standard. A similar renaissance is taking place with the adoption of smart home technology, which allows residents to control their home's functions through voice commands, smartphones and tablets. The array of features includes smart thermostats, light switches, wall outlets, doorbells, locks and more, all controllable by asking "Alexa, can you turn the temperature to 68° and unlock the front door?" ("Of course, Mr. Pathfinder."). These technologies are becoming standard in new apartment developments and are showing up in more renovations to existing buildings. Lennar, a major homebuilder, recently announced it will pre-install a full suite of smart home features in all 35,000 homes it will build in 2018. So, if you don't already know Alexa, you will soon.



[Editor's Note: Pathfinder is testing smart technology features in several of our apartment renovations as well as several new developments.]

The Rent Control Debate

The rent control debate is heating up in California for the first time in decades. The potential statewide repeal of Costa-Hawkins – which limits the rent control policies cities can enact – is on the ballot in November. Here's our attempt to frame both sides of the issue. Proponents of the Costa-Hawkins repeal (which would remove restrictions on the rent control measures cities can enact) and of rent control overall, are frustrated with rising rents and homelessness and believe government should step in and regulate the free market. There's no doubt that rents have risen steadily in many major markets in the U.S. during the past decade. An improving economy, immigration and migration to major cities has driven the demand side and a lackluster construction pipeline for new housing has crimped supply. In Econ 101 terms, supply has not kept up with demand in these hot cities and rents have skyrocketed.

Opponents of the Costa-Hawkins repeal (and opponents of more government rent control in general), cite several independent economic studies, including the December 2017 Stanford study, along with data from cities that previously enacted rent control. Their rather straightforward argument – rising rents are a supply and demand issue and rent control only creates a temporary reprieve for existing tenants but can drastically hurt supply in the long run as developers shift to cities without rent control (or don't build at all). Additionally, as the Stanford study points out, rent control has been shown to hurt the quality of the existing housing stock as landlords will chose to invest their money elsewhere rather than into maintenance of their apartment buildings. Quality suffers, pitting landlord against tenant (i.e. the slumlord conundrum).

[Editor's Note: We believe there are better approaches to solving the state's housing crisis including streamlining new development and the permitting/inspection processes, creating incentives for greater density near transit stops, placing reasonable restrictions on short-term rentals (which removes housing stock for area residents) and expanding the existing government assistance programs for low-income renters. Ultimately, rental rates are a supply and demand issue. History has shown that blunt force measures like rent control – although appealing to many in the near term – generally do more long-term harm than good and create unintended consequences.]

TRAILBLAZING: THE MADDOX, MESA (PHOENIX), AZ

The Rebirth of an Apartment Community

In Greek mythology, a Phoenix is a mystical bird that symbolizes renewal and resurrection. Associated with the sun, a Phoenix cyclically regenerates and obtains new life by arising from the ashes of its predecessor. At Pathfinder, we find our apartment communities often mimic the Phoenix. This is particularly true at our Maddox property in the Phoenix area.

The Maddox (formerly Windemere) is a 1986-vintage, 224-unit apartment community located in Mesa, Arizona adjacent to the town of Gilbert – a suburb known for its family-friendly environment, outstanding schools and vibrant, downtown Heritage shopping and dining district.

The property spans 12 acres and includes 18 two–story garden style buildings with a mix of one- and two-bedroom units averaging 836 square feet. Residents enjoy two swimming pools with a spa, clubhouse, fitness center, basketball court, children's playground, pet wash, dog park and a car wash facility. When we purchased the property in the summer of 2016, no upgrades had been completed to any interior units or the common areas in over 30 years. The property was in need of a serious make-over and presented an opportunity to transform a well-located, previously untouched apartment community.

Our business plan was to implement professional management, remedy deferred maintenance, rebrand the property, modernize the unit interiors and enhance the property's exterior by improving the landscape, hardscape and leasing entrance, and upgrade all common areas. To date, we have transitioned to our preferred management company, completed deferred maintenance, rebranded the property, renovated about 25% of the apartment interiors, installed a resident package locker system, painted the exterior and renovated the clubhouse, leasing office, fitness center and pool area. The improvements have pulled the property out of the 1980's and into the 21st century.

Renovated Clubhouse

New Outdoor Lounge Area

Renovated Leasing Office

Renovated Fitness Room

We couldn't be more pleased with the transformation of The Maddox. We enjoy bringing new life into a community and seeing families and friends enjoying enhanced living spaces and shared amenities. There is something to be said about enhancing the cycle of life – at The Maddox, life just got much better.

PHOENIX: Did You Know?

Ranked First in Population Growth: Maricopa County, which includes Phoenix and other cities in the metropolitan area, gained 74,000 residents from March 2017 to March 2018, according to U.S. Census data – the most of any U.S. County. Clark County, NV (Las Vegas) was second with 47,000 new residents. Phoenix added 544,000 residents from 2010 to 2017, a 13% growth rate – one of the fastest in the U.S.

The Rise of the Silicon Desert: Phoenix is becoming a magnet for start-up and technology companies fueled by a low-cost business environment, a more affordable quality of life and a strong talent pool. Here are some of the statistics:

- Office rents in Phoenix are 70% less than Silicon Valley, Seattle and San Francisco.

- Businesses are not subject to S.F. Bay-area-type salaries – in Arizona the average wage of a technology employee is $92,000, a 48% savings when compared to San Francisco.

- Arizona's lower cost of living allows employees to enjoy a higher quality of life – the median home price in Phoenix is $240,000 compared to $1,300,000 in San Francisco and $733,000 in Seattle.

- Phoenix offers a large talent pool – nearly 30% of Phoenix's 4,700,000 residents hold a bachelor's degree and 22% are Millennials, a sought-after demographic by tech companies.

- *BBC News* ranked Arizona first in the U.S. for finance and insurance industry job growth.

Bill Gates Invests $80 Million to Build Smart City: An entity associated with the Gates Investment Company has invested $80 million in a high-tech planned development on a 24,800- acre site outside Phoenix, called Belmont. The developers, Belmont Partners, plan to build a mix of residences, public schools, commercial and retail spaces all designed around high-speed networks, self-driving cars, high-tech manufacturing facilities and automated logistics hubs. Belmont Partners said it will be similar in size to nearby Tempe, Arizona, which has a population of 182,000. The planned development will be located along the proposed I-11 freeway, which would run from Reno to Mexico and connect Belmont to Phoenix and Las Vegas.

NOTABLES AND QUOTABLES

Balance

"Life is like riding a bicycle. To keep your balance, you must keep moving."

- Albert Einstein

"In art and dream, may you proceed with abandon. In life, may you proceed with balance and stealth."

- Patti Smith, *American Singer-Songwriter*

"Life, like surfing, is all about wave selection and balance. Never let the best waves in life go by."

- Unknown

"The key to keeping your balance is knowing when you've lost it."

- Unknown

"The major work of the world is not done by geniuses. It is done by ordinary people, with balance in their lives, who learned to work in an extraordinary manner."

- Gordon B. Hinckley, *Mormon Scholar*

"Life is about balance. The good and the bad. The highs and the lows. The pina and the colada."

- Ellen DeGeneres

"Balance is not something you find, it's something you create."

- Jana Kingsford, *Australian Author*

"A well-developed sense of humor is the pole that adds balance to your steps, as you walk the tightrope of life."

- William Arthur Ward, *American Author*

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Please add msiegler@pathfinderfunds.com to your address book to ensure you keep receiving our notifications.