IN THIS ISSUE

CHARTING THE COURSE

2020: Time to Pivot Your Investment Strategy?

By Mitch Siegler, Senior Managing Director

Looking back over the past decade, we see two distinct investment phases and looking around the bend, we're seeing a third phase taking shape. Investing for growth – a strategy that served investors well at the depths of the equity and real estate market collapse in 2009 – shifted to more of a value investing strategy after the markets recovered in 2012-2014. Now, with values near peak levels for this cycle, investors may be well served with a steady-Eddie, income-oriented approach emphasizing dividend-paying stocks or stabilized, income-generating properties. We'll cover these two prior phases and point out a few reasons we think an inflection point marking the shift to a third phase may be near.

Phase I, 2009-2014, Growth Investing

On March 9, 2009, the S&P 500 had plummeted to 673, down 64% from its 2007 peak of 1,890. (At press time, it's 3,093, an increase of more than 350% from the nadir.) In 2009, it was also a buyer's market for real estate as non-performing loans and bank foreclosures had skyrocketed and the opportunity to buy half-empty retail centers and office buildings, partially constructed condo projects and finished residential lots at deep discounts to the prior owner's invested capital were there for the taking. Sure, buying anything at that time wasn't for the faint of heart and there were many twists and turns along the way but investors who took the plunge then did quite well.

Equity investors did best on what to many looked like the "riskiest" stocks; technology companies have been among the best performers of the past decade. Investors who took the plunge buying well-located properties from lenders generally hit it out of the park because their cost basis was so low – they benefited most as markets recovered. The well-located apartment buildings we bought then are today worth double or triple – and the multiple of invested capital on those investments often exceed the above returns on equity investments.

In the early years of this cycle, prices for most assets were so beaten down that it almost didn't matter what you bought – everything was worth a lot more a few years later. Since the world didn't come to an end, assets perceived as riskier performed better but everything – blue-chip, value and growth stocks and most properties – did quite well.

Phase II, 2014-2019, Value Investing

By 2012, markets had turned up dramatically, with the S&P 500 ending the year above 1,400, more than double the March 2009 trough. During the 2014-2019 period, investors in growth stocks continued to have a great run. In fact, the annual return of the growth index from 2014 to 2019 was 13.6% as compared with 8% for the value index. Easy money helped investors take more risks, and they have been rewarded so far for doing so.

For real estate investors around 2012-2014, it wasn't nearly so gloom-and doom and opportunities to buy foreclosed properties from lenders, were by then, basically nonexistent. Banks had disposed of many of their riskiest properties and the 2009 buyer's market had shifted to a more balanced market, even a seller's market, as considerable capital flooded into real estate and the banks, which had stronger balance sheets and far fewer non-performing assets, had more pricing power. By 2014, truly distressed real estate buyers were mostly a distant memory.

Around this time, we shifted from the higher-octane approach of buying partially constructed condo projects, land and commercial projects with high vacancies to acquiring well-located, bread-and-butter apartments and adding value to them. We felt that housing supply and demand were imbalanced, and we were keen to buy existing apartments below replacement cost. We searched far and wide for long-terms owners who really didn't give their '80's and '90's-vintage properties much love and starved them of capital and then we infused millions to transform these properties and dramatically boost rents and income. The strategy served us and our investors well and we think the strategy still has legs. Compared with our brethren in the equity investing world, we played it quite safe.

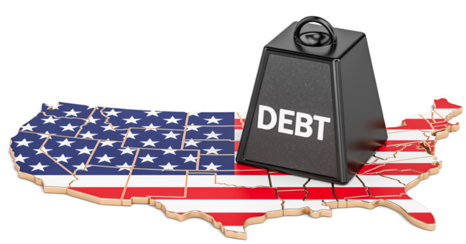
Phase III, 2019-202(?), Income Investing

As we make our case for why we may be nearing an inflection point and investors may wish to consider pivoting their investment strategy, here are ten observations about the current landscape that informs this view:

1. **Economic growth is slowing** worldwide with some important markets on the cusp of recession. Last month, the International Monetary Fund (IMF) reduced its 2019 global growth forecast to 3.0%, the lowest level since the 2009 recession. The IMF is hopeful that growth will tick up to 3.4% next year. Consider that this is the global average which benefits from China's strong 6.3% rate and India's 5.0% rate. Closer to home, the IMF's estimate for the U.S. is 2.0% with Europe and Japan even lower. If there's a further slowdown in China, all bets are off. The U.S./European/Japanese growth rates, while better than a poke in the eye with a sharp stick, are nothing to write home about.

2. **Geopolitical risks remain.** Now, there are always geopolitical risks but when you look at today's list (China/Hong Kong, Turkey/Syria, North Korea, Iran, Brexit, Impeachment Inquiry, etc.), it feels longer than usual.

3. **Fiscal and monetary stimulus are proving the law of diminishing returns.** The 2017 tax cuts boosted the U.S. economy in 2018 but the long-term benefits could be less. Quantitative Easing (QE) – rounds 1, 2 and 3 – could soon be followed by QE4. As the Bank of Japan and the European Central Bank have seen, it's hard to force credit on those who don't really want it; increases in the savings rate even with zero or negative interest rates are probably not what central bankers expected.



4. **The U.S. budget deficit is nearly $1 trillion** this year, driven by large military spending and interest on the debt. Since deficits rise as the government increases stimulus during recessions and it's been more than a decade since the last recession, odds of the deficit shrinking anytime soon are slim – and that's with interest rates at record-low levels – hold on to your seats should rates rise. And all of this is before we see any of the big-ticket spending plans being bandied about (like universal health care/Medicare for all, free college tuition, reparations, etc.)

5. **Cracks in the confidence façade are showing up** more and more. The Boeing CEO's 737 Max testimony to Congress in late October makes the aircraft manufacturer's execs look like The Gang That Couldn't Shoot Straight. Facebook is being attacked from every direction. The much ballyhooed WeWork IPO collapsed. More "do no wrong" tech unicorns are having challenges raising capital.

6. **Low/negative interest rates are pushing investors to take on more risk.** We've all read about Scandinavian banks offering mortgages that require payoffs years in the future lower than today's loan amount. Or banks paying depositors negative interest rates (e.g., depositors paying the bank to store their money). Last month, Greece issued €487.5 million ($535.31 million) of three-month debt at a yield of ***negative*** 0.02%. Even in the U.S., real interest rates are negative. While a saver might earn 1.9% on the highest-yielding money market accounts, that's small consolation when inflation is running 2.5%-3.0%, meaning real interest rates are ***negative*** 0.6% to 1.1%. We don't pretend to make sense of this Alice in Wonderland stuff.

7. **Flashing yellow lights: Debt funds and pension funds.** During the past decade, as regulators have scrutinized banks to prevent another foreclosure and subprime mortgage-type crisis, hundreds of billions of investor dollars have flowed into unregulated financial institutions operating outside regulators' purview. Their rates are higher than banks' and they'll generally take more risk, allowing second-tier borrowers to push leverage, often on sketchier projects

in riskier markets. While we don't expect many bank foreclosures as they've been cautious, debt funds could be a source of distress. When we read about pension funds' high spending commitments for their retirees and the correspondingly high long-term returns needed to meet their obligations, we scratch our heads. Long-term returns of 7-8% for groups like CalPERS (California Public Employees Retirement System) are – and we're being as diplomatic as possible here – unlikely – given their predominant mix of equity and fixed income investments, which are virtually assured to see lower returns in the next few years than in the past.

8. **Fed machinations.** In the past year, the Fed has raised rates, then cut them; shrunk, then expanded its balance sheet; injected, withdrawn, then injected liquidity. The Fed has a large budget and some awfully smart people. This behavior doesn't square with Fed officials being clueless or confused. More likely, we're at an economic turning point of some sort.

9. **Negative real interest rates and other relationships that are out of whack.** At press time, the S&P 500 dividend yield was 1.80%, near the 10-year Treasury yield of 1.81%. This parity is unusual.

10. **Other warning signs** include high-yield, highly-leveraged and covenant-lite loans, which the IMF estimates exceed $19 trillion. This "debt-at-risk," from firms whose earnings would not cover the cost of their interest expenses could rear its head in a recession or economic slowdown.

So, in this topsy-turvy environment, we think an abundance of caution is in order. Our investors have been telling us for years they'd like more income and they don't see opportunities to find it in traditional equities and fixed income. We're partial to real estate – it's a hard asset, after all, and comes with tax-sheltering aspects by virtue of depreciation. And, it appears that the supply/demand imbalance we've seen in rental housing for the past many years remains firmly in place, especially in markets with strong population and job growth.

For these reasons, we've laser-focused our investing strategy during the past few years to apartments in a handful of growth markets. Looking ahead, we plan to hold properties longer and lock-in longer-term, fixed-rate debt – we can borrow for the long haul today at under 4.0%. And, we're planning to emphasize stabilized apartments, which are throwing off attractive cash flow immediately (5% per year and growing).

At some point, investors will see attractive value and growth investment opportunities again. But there's a season for everything and we think the season to play it safe and clip coupons (investing for cash flow via dividends or property income) is fast approaching.

Mitch Siegler is Senior Managing Director of Pathfinder Partners. 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

Keeping an Independent Fed

By Lorne Polger, Senior Managing Director

The Federal Reserve ("Fed"), the country's central bank, is separate from the executive, legislative and judiciary branches of government. The Fed's Board of Governors consists of seven members who, along with the President of the New York Fed and a rotating set of four other Presidents of the regional Fed banks, set monetary policy for the country. The members of the Board, except for the Chair and Vice Chair, serve 14-year terms. The Chair's term, on the other hand, begins in the middle of a President's four-year term. These mechanisms are designed to insulate Fed members from political pressures.

The Fed balances twin goals of low unemployment and low inflation. Its decisions can impact groups differently. When unemployment is high and our friends and neighbors are struggling to make ends meet, few can argue with flooding the monetary system to stimulate the economy and spur hiring. But, when the pendulum swings too far in the other direction, we risk high inflation a year or two later and that's bad for nearly everyone.

Since 1977, the Federal Reserve has operated under a mandate from Congress to "promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates" — what is now commonly referred to as the Fed's "dual mandate." Think high employment, low inflation. As a result, the Fed's decisions have an important impact on both the economic and political climates. For this reason, there have been situations (including, most recently, President Trump's attacks on the Fed and its current chairman, Jay Powell) where politicians have tried to influence the Fed's decisions. But Trump is not alone. In 1972, President Nixon successfully pressured the Fed Chairman to cut a key interest rate to stimulate the economy ahead of his 1972 reelection. This contributed to the hyper-inflation of the late '70s, which required double-digit interest rates under Chairman Volcker in the '80s to tame.

Should we care if the Fed is independent? Just because it always was, doesn't mean it always should be. The arguments follow below.

What Fed 'Independence' Really Means

The independence of the Fed is not about its policies, it's about how the policies are implemented; i.e., whether political pressure is involved. Historically, Congress has set various mandates for the Fed to follow and central bankers place public interest at the center of their deliberations.

As noted by Boston Fed President Eric Rosengren this July: *"For the Federal Reserve, while long-term goals are determined by Congress, the day-to-day implementation of policies is and should be conducted based on data and technical analysis, independent of short-term political objectives."*

At present, the Fed tries to keep inflation around 2%, while also maximizing employment. Congress outlined these goals, but the Fed itself chooses how best to use monetary policy (i.e., setting interest rates) to achieve those goals.

The Case for an Independent Fed

Independence helps to ensure that the Fed can make difficult decisions in the long-run best interest of the economy, and not in the short-term political interest of the party in power. Large interest rate moves this year can impact growth, inflation, employment and the overall economy for many years.

At various times, the Fed has lifted interest rates to lower inflation or cool an overheating economy. At other times, the Fed has cut rates to stimulate hiring and investment and to give the economy a needed boost. Both actions can be painful for various segments of the population – there are usually winners and losers from whatever action the Fed takes. Of course, in the apartment business, we like lower rates. Lower cost of debt generally enables us to increase our cash flow, a positive for Pathfinder and its investors.

President Rosengren noted in his July remarks: *"With greater clarity on goals, and more transparency and communication around how policymakers alter policy to achieve those goals, there has been considerable success in changing the inflation experience…The high and variable inflation of the 1970s has been replaced by a low and remarkably stable rate of inflation since the early 1990s."* Studies have found countries with more independent central banks, such as the U.S., have lower inflation rates than those with less independent central banks.

Without autonomy, the Fed could be pressured by election-focused politicians to enact an excessively expansionary monetary policy to lower unemployment in the short-term. This could lead to high inflation over the long-term.

Advocates of Fed autonomy argue that an independent Fed will better address long-term economic objectives. Independence can also make it easier to execute policies that are politically unpopular but serve a greater public interest.

Is there a simple way to carry out monetary policy? I don't think so. We've tried and failed with the gold standard, fixed exchange rates and a strategy in the 1970's which aimed to keep the expansion of currency in circulation and bank deposits within a target range.

The Case Against an Independent Fed

Critics of an independent Fed argue that it is unconstitutional for Congress to assign a constitutional power to an independent government agency. Congress has the power to coin money and regulate its value. In 1913, Congress delegated this power to the Fed. However, some argue that such a delegation is fundamentally unconstitutional. Opponents of Fed independence also suggest that it is undemocratic to have an agency that is unaccountable to the voting public, dictating monetary policy.

Currently, other leading central banks have much lower (and in cases like Sweden, Denmark, Switzerland and Japan, negative) rates, have banks paying borrowers to borrow their money, and in some cases, depositors paying banks to accept their money (can you imagine that here in the U.S.? I can't). That's the crux of President's Trump's argument – the Fed needs to consider its rates relative to those of the other major countries/markets. The argument is that the Fed shouldn't be operating in isolation. The U.S. is part of a global economy and monetary policy is more complex than in Nixon's day.

Lessons from the Great Recession

Arguments that the Fed needs direct oversight or that it should do what the President wants betray a misunderstanding of what it means for a central bank to be independent and how monetary policy is carried out.

If the Fed loses its independence, then its policy will become less sensitive to what's going on in the real world and more of a hostage to politicians, who know far less about designing and implementing monetary policy. I believe that would be a significant step backward and could be disastrous. In fact, the way central banks carry out monetary policy in financially developed economies needs to be constantly reviewed. Or more accurately, rewritten, as demonstrated by the deliberations of Fed officials during the financial crisis of 2007-2009, when they pulled out all the stops (easing financial conditions by employing a variety of unconventional monetary policy tools that altered the size and composition of its balance sheet, including slashing interest rates, and employing various forms of quantitative easing or "QE") to right an economic ship that was foundering on the rocks.

The most significant economic downturn since the Great Depression threatened global economic and financial stability and drove unemployment through the roof. In response, the Fed brought its target interest rate down to zero and with its QE program, purchased massive amounts of longer-term, mortgage-backed securities and government bonds. In response, unemployment fell from a peak of nearly 10% to the current level, 3.5% and the economy grew mightily. By late 2015, the Fed began gradually raising rates. And last October, the Fed began reducing the size of its greatly enlarged balance sheet of U.S. government securities.

There was not consensus about the moves that the Fed took. That said, in part due to the Fed's flexibility and Congress' willingness to adapt to new and unexpected circumstances, the U.S. economy has grown steadily since 2009, while the unemployment rate has concurrently hit all-time lows.

In hindsight, would results have improved had the Fed been subject to congressional review of its decisions in real time? Or if the Fed had been subject to presidential or political pressures to change its decisions? Highly unlikely, in my opinion. I believe that policy conducted for political ends, could easily increase economic turbulence and harm the economy. Independence has worked well for over 100 years. Let's leave it be.

Lorne Polger is Senior Managing Director of Pathfinder Partners. 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.

GUEST FEATURE

Let It Ride

By Brent Rivard, Managing Director

Albert Einstein famously remarked, "The most powerful force in the universe is compound interest."

Think about it this way: If you earn 10% each year on your money and you don't reinvest that income, it will take you ten years to double your money. But, if you reinvest the income each year, the doubling will happen much faster – in just over seven years.

When parents advise their kids to save a portion of their income and start that process early, it's for good reason. If you save just $200 per month at age 40, and earn just 5% per year on that money, the nest egg will grow to a whopping $163,000 by the time you're 75. Increase the 5% to 7% and the nest egg is $234,000. Start saving that same amount at age 25 and you'll generate three times more money – $514,000 at 5% and $1,006,000 at 7%. Einstein, of course, was right!

Pathfinder's value-add multifamily investing approach demonstrates the compounding effect. While some real estate investment companies distribute current income and raise additional capital to fund property improvements, Pathfinder chooses to reinvest the income generated by our projects directly into the property for the first couple of years. These improvements drive increases in rent and net operating income which have a compounding effect on property values and investor returns.

But it's not just about the reinvestment of income, it's also about the *efficient* reinvestment of income. Often, we see investors who have significant idle cash in savings accounts that, in today's interest rate environment, pay them almost nothing. Meanwhile, there are plenty of money market account-type products that pay more than a savings account. Putting the money to work as soon as you receive it (or at least in the same month – rather than a quarter or a year later) accelerates the compounding effect. It doesn't look like much at any moment but over the span of a lifetime, small changes like this really add up.

The same compounding and efficient investing principles also work with deferral of income taxes. Fans of 1031 Exchanges know that by immediately rolling over the gains from the sale of property A into a new investment in property B can lead to the deferral of income taxes for years, sometimes decades. While the taxman will eventually come calling, paying the bill down the road leaves more money for investment (and for growth) today.

The new Opportunity Zone rules enacted in 2017 have a similar effect. These rules incentivize investment in certain areas in exchange for tax deferral and potentially even tax elimination. But like 1031 Exchanges, those benefits come at a price. You must be willing to make significant investments in the property (i.e. complete redevelopment or new construction) which comes with higher risk. For 1031 Exchanges, you need to reinvest the proceeds in accordance with strict rules, which sometimes encourage investors to make investments they wouldn't otherwise make. Our approach is to analyze an investment without regard to any tax advantage. If you would still invest, then the tax benefits are icing on the cake and compounding benefits, here we come! We caution investors that an investment should stand on its own, irrespective of tax benefits.

Pathfinder's newest fund, the Pathfinder Partners Income Fund, L.P. similarly enables investors to rollover gains and distributions from prior Pathfinder Funds into an income vehicle that is expected to generate 5% annual cash distributions immediately and enables investors to defer taxes on the prior gains. By comparison, an investor with $100 in gains and in a 50% tax bracket (aka a California investor!) would have just $50 net of tax to invest and would need to earn 10% on that after-tax amount to get to the same place as for a 5% yield on our tax-deferred vehicle. As such, that investor would likely have to take more risk in order to achieve the same cash yield. It's just another way of looking at the power of compounding – and the value of letting it ride.

Brent Rivard is Managing Director, CFO and COO of Pathfinder Partners, LP. Prior to joining Pathfinder in 2008, Brent was the President of a national wealth management firm and CFO/COO of a one of southern California's leading privately-held commercial real estate brokerage firms. He can be reached at brivard@pathfinderfunds.com.

ZEITGEIST – SIGN OF THE TIMES

How Zoning Reforms Can Help Tackle the Housing Crisis

Municipalities across the U.S. including Portland, San Francisco and San Diego, are implementing smart, forward-thinking parking policies to help combat the nation's ongoing housing crisis. As NIMBYism (Not In My Backyard) attitudes make it increasingly difficult to get housing projects approved, cities have begun scaling back or removing parking requirements entirely to get higher-density projects approved on smaller parcels of land. Prior to the removal of the parking restrictions, zoning regulations required fixed numbers of parking spaces for each housing unit, making developments significantly more expensive by requiring an underground garage or additional land. Costs vary depending on location and the type of parking garage but each parking spot can add $50,000 to $100,000 to the cost of a new housing unit.

In addition to helping make a dent in the housing crisis by lowering development costs, lower parking requirements also translate into a smaller environmental footprint. Advocates of lower parking requirements believe developments with less parking will result in fewer cars (and more ridesharing) and a corresponding reduction in carbon emissions.

Portland's City Council is currently reviewing a "Better Housing by Design" policy aimed at alleviating their housing shortage (estimated at 155,000 housing units) by amending existing density regulations and eliminating minimum parking requirements. In San Diego, the City Council recently removed minimum parking requirements for new projects built near transit areas. In Minneapolis, city leaders abolished single-family zoning altogether and replaced it with new regulations allowing up to three dwelling units per parcel.

As the housing crisis worsens and legislators in many cities look to policies like rent control, some thoughtful city governments are looking at the root of the problem – a lack of supply, partially driven by outdated parking requirements – and have implemented simple, practical solutions.

Property-Specific Amenities Help Create a Strong Community

In the recent past, renting an apartment was viewed as a less desirable housing option for people who could not afford to buy a single-family home or condominium. Times have changed. According to Harvard's *Joint Center for Housing Studies*, the number of American renters making over $100,000 increased by 5% in 2017 to 19%, an all-time high. Today, renting is a lifestyle choice that offers flexibility and often, walkability and easy access to amenities and services. In order to stay competitive, today's landlords must offer amenities that mirror their specific community's demographic and lifestyle preferences in order to attract and retain quality residents.

More than three-quarters of renters participating in the National Multifamily Housing Council's (NMHC) *2018 Consumer Housing Insights Survey* said they were working toward achieving a healthier lifestyle. Apartment communities are responding with interactive fitness classes, bikes and treadmills equipped with the latest technology (including touch screen displays that take you to exotic locations in high-definition), virtual fitness coaching, and of course, instant access to all of your favorite streaming channels, social media accounts and web content.

Bark Park with Pet Exercise Toys at Seattle-Area Apartment

About 83% of the survey's respondents said face-to-face socializing with friends and family is an important consideration in housing, signaling the ongoing importance of community gathering spaces. And these gathering areas are no longer just a place to sit on stylish couches; communities are now activating these spaces with internet bars, movie and game nights and high-end, automated coffee machines. Package delivery lockers – which have become mandatory at most communities with the growth of Amazon delivery services – are doubling as photo murals adorned with images reflecting the local lifestyle. Pets are being pampered with bark parks with aerobic equipment, customized wash spas and "yappy hours" for pets and their owners.

We understand the importance of providing amenities specifically tailored to the residents of each of our properties so we thought we would share some photos of recently constructed amenities within our portfolio.

Community Gathering Area with Wireless Internet Bar at Denver-Area Community

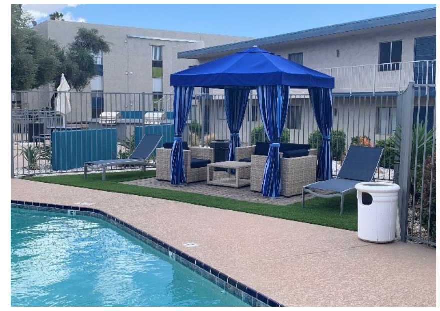
Package Locker featuring Local Art at Portland-Area Community

Cornhole/Horseshoe Area at San Diego Apartment

Outdoor Yoga and Stretching Area Overlooking Fountain at Phoenix Community

TRAILBLAZING: AVALON APARTMENTS, PHOENIX, AZ

Finding Good Fortune in the Valley of the Sun



New Pool Cabana, Turf, & Pool Furniture

New Entrance Canopy

> ***"The sun – the bright sun, that brings back, not light alone, but new life, and hope, and freshness to man – burst upon the crowded city in clear and radiant glory."***
>
> **– Charles Dickens**

Phoenix, also known as "the Valley of the Sun", has an average of 299 sunny days per year – more than any other city in the U.S. Phoenix also has the highest job and population growth in the nation as Americans flock to the region for its affordable housing and high quality of living. We've made 15 investments in the greater Phoenix area since 2011 and in 2017, we acquired Avalon Apartments, located in an up-and-coming area in central Phoenix, just five miles from downtown. Our business plan was to renovate the property and hold it for five to seven years as the surrounding neighborhood continued to improve.

Avalon, built in 1973, is situated on 3.5 acres and includes 117 apartments averaging 830 square feet. The property contains large open spaces and a variety of community amenities including a resort-style swimming pool, barbeque and outdoor lounge areas, fitness center, dog park, solar energy panels and covered parking. Avalon sits between downtown Phoenix and Camelback Mountain just west of Arcadia and south of Indian School Road, a major east-west thoroughfare with several retail centers and numerous restaurants. Residents have a short commute to the Camelback employment corridor and can walk to various nearby shopping, dining and recreational facilities.

Over the past 20 years, Phoenix has consistently ranked among the fastest-growing cities in the U.S. and has recently become a nationwide leader in several additional economic indicators. According to recent Census data, Phoenix welcomed an average of 43,000 residents each year between 2013 and 2017, the highest in-migration in the nation. Maricopa County – where Phoenix is located – is home to one-half of Arizona's population and is also the fastest growing county in the U.S. The State of Arizona saw GDP climb by 4% in 2018, the fourth fastest in the nation, and the Kaufman Index, a leading indicator of new business creation in the U.S., ranked Phoenix as one of the top metro areas for startups and entrepreneurship for the last four years.

A highly skilled labor force coupled with a low-cost, business-friendly environment continues to attract companies to relocate to or expand operations in Phoenix. Downtown Phoenix is currently home to more than 300 technology companies compared with 67 in 2012. The City is also home to numerous large financial services companies including American Express, Discover, USAA, Charles Schwab, Vanguard, Nationwide Financial, Allstate, Wells Fargo, Bank of America, Chase, PayPal, Paychex, Northern Trust and Quicken Loans. The area is benefiting from an influx of residents migrating out of high-cost states like California seeking a lower cost of living, quality educational institutions and abundant outdoor activities.

When we acquired Avalon, it was just 76% leased in a submarket with a 90-95% average occupancy, providing an immediate opportunity to substantially increase the property's cashflow. Within four months of our acquisition, we were able to stabilize operations and bring occupancy above 90%.

Earlier this year we began our interior renovation program including upgrading the kitchens (modern appliances, new cabinets and hardware, countertops/backsplashes, light fixtures and flooring), bathrooms (sinks, faucets, light fixtures, hardware, mirrors and bathtub surrounds) and replacing the living area carpet with faux wood, vinyl flooring. We also enhanced the property's curb appeal through new exterior paint and landscaping, upgrades to the façade, improved common area gathering spaces and the addition of shade trellises.

We are pleased with the progress at Avalon as well as the continued improvement of the neighborhood. As the Phoenix market continues to grow, the future of the City – along with our Avalon community – couldn't look any brighter.

NOTABLES AND QUOTABLES

Dedication

"Genius is one percent inspiration, ninety-nine percent perspiration."

- Thomas Edison,
American Inventor

"Some people want it to happen, some wish it would happen, others make it happen."

- Michael Jordan,
American Basketball Player

"It's not that I'm so smart, it's just that I stay with problems longer."

- Albert Einstein

"Success, like happiness, cannot be pursued, it comes only as a result of dedication."

- Viktor Frankl,
Austrian Psychiatrist

"He who would learn to fly one day must first learn to stand and walk and run and climb and dance; one cannot fly into flying."

- Fredrich Nietzsche,
German Philosopher

"I know the price of success; dedication, hard work and an unremitting devotion to the things you want to see happen."

- Frank Lloyd Wright,
American Architect

"To create something exceptional, your mindset must be relentlessly focused on the smallest detail."

- Giorgio Armani,
Italian Fashion Designer

"The key to success is dedication to lifelong learning."

- Stephen Covey,
American Businessman

"A dream doesn't become reality through magic; it takes sweat, determination and hard work."

- Colin Powell,
American Army General

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Investing involves risk of loss and you should be prepared to bear investment loss, including loss of original investment. Real estate investments are subject to the risks generally inherent to the ownership of real property and loans, including: uncertainty of cash flow to meet fixed and other obligations; uncertainty in capital markets as it relates to both procurements of equity and debt; adverse changes in local market conditions, population trends, neighborhood values, community conditions, general economic conditions, local employment conditions, interest rates, and real estate tax rates; changes in fiscal policies; changes in applicable laws and regulations (including tax laws); uninsured losses; delays in foreclosure; borrower bankruptcy and related legal expenses; and other risks that are beyond the control of Pathfinder or the General Partner. There can be no assurance of profitable operations because the cost of owning the properties may exceed the income produced, particularly since certain expenses related to real estate and its ownership, such as property taxes, utility costs, maintenance costs and insurance, tend to increase over time and are largely beyond the control of the owner. Moreover, although insurance is expected to be obtained to cover most casualty losses and general liability arising from the properties, no insurance will be available to cover cash deficits from ongoing operations.

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