THE PATHFINDER REPORT

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IN THIS ISSUE

CHARTING THE COURSE

Maybe It's Time to Rethink a Few Things

By Mitch Siegler, Senior Managing Director

"Progress is impossible without change. Those who cannot change their minds cannot change anything."

- George Bernard Shaw, Playwright/ Nobel Prizewinner for Literature

In "Think Again", Wharton organizational psychologist and *New York Times* best-selling author Adam Grant disproves the adage that you should never change your answer on an exam because the odds are you'll change a correct answer to an incorrect one. He cites a study of 1,500 students which found this occurred only one time in four; half the time, first instincts were wrong and wrong answers were changed to right ones. The reason: the act of thinking deeply *about* whether you should change the answer rather than blindly remaining anchored to your initial answer leads to a better result.

Sadly, many of us have an aversion to rethinking. We prefer the certainty of a predictable world and a stable environment. Flexibility doesn't come naturally to many in this complex, modern and rather rigid world. Change is difficult.

Consider how crazy things became during the pandemic as our lives were upended and we learned new ways of doing so many things with lightning speed. Many feel that questioning ourselves, our thinking and our decision making makes life more unpredictable. The opposite is often true.

Let's examine rethinking through four prisms: the pandemic; companies which failed to adapt; social media; and investor attitudes. And let's explore a few strategies for strengthening our own rethinking muscles and improving our rethinking mindsets.

Covid-19

During our lifetimes, has there ever been a more critical time for rethinking? During the pandemic, world leaders were S-L-O-W to rethink their assumptions, which set the stage for further complacency and denial by ordinary people. The result: countless unnecessary deaths and prolonged economic destruction.

There are just a *handful* of Covid cases. Surely, Covid won't affect *our* nation. Even if it does, it probably *won't be deadlier* than the flu. And even if it is, it *won't be transmitted* by those without symptoms. And even if we're wrong about all of that, surely our best-in-class *health care system* will keep us out of harm's way. Blind faith, arrogance and absolute certainty led many to cling to yesterday's bad ideas.

The pandemic has prompted many others to rethink long-held beliefs: Is it safe to work in an office, fly on an airplane, eat indoors at a restaurant or hug our grandparents? Many are still wrestling with these and other weighty questions. Meanwhile, whoever considered that we might not be able to purchase hand sanitizer or toilet paper at the drop of a hat?

Many of those who struggled emotionally during the pandemic also clung to their pre-pandemic habits and mindsets. Many who thrived, thought differently, shifted gears, and operated in new and different ways.

Companies Which Failed to Adapt

When asked "How did you go bankrupt?", Hemingway's character in The Sun Also Rises replied "Two ways: gradually, then suddenly." It's the same with formerly great companies which lost their way.

We've all heard stories of once great companies which weren't sufficiently nimble, creative, or introspective to adapt to changing circumstances. Not only didn't they continue to thrive, many didn't even survive. Blackberry. Kodak. Polaroid. Sears. Blockbuster. Toys R Us. The list goes on. Many had demonstrated decades of success before failing. What happened? There were many contributing factors, of course, but at the core these former bellwether organizations failed at rethinking. They were complacent about their positions in the marketplace and lackadaisical about changing course.

Social Media and the Importance of Divergent Ideas

Take social media. Please. Facebook and Instagram are built around the idea that humans are most comfortable with views and opinions most like their own. It's a rare breed who seeks out divergent news sources, holds contrarian opinions and opens herself enthusiastically to others with opposing viewpoints. This explains, in large part, why Americans have become so polarized, so tribal with their political and social views.

Emotionally healthy people regularly try new things – they expose themselves to new interests, hobbies, art, and entertainment. They seek out others with views and opinions which are different from their own. They curate multiple sources of news and information – many which seem to be in editorial conflict with each other. These consumers of information are rare and they're at odds with the financial objectives of a company like Facebook – if more people took this approach, FB's business model would be seriously threatened.

It's always a good time to shake things up, read something new, walk away from something old and open yourself up to others with fundamentally different viewpoints. This form of rethinking can help get us out of our comfort zones, spur curiosity and spark innovation. If more people took this approach, we might just find more common ground and understanding.

Stock Market Investing

Investors have realized outsized returns since the March 2020 market lows. Today, signs of heightened risk are everywhere. China. Washington, D.C. Atlanta – where the Center for Disease Control is headquartered. Jackson Hole – home to the Fed's economic symposiums.

Today, individual investors' stock holdings are at record levels and many investors do not regularly rebalance their portfolios, pursue hedging strategies or shift to cash to protect against a market decline. If the market moves to a correction or – gasp – a bear market, most investors will shrug their shoulders, shed a few tears, and say "What could I have possibly done to anticipate or prepare for this?" They will have thought consistently, linearly, and incorrectly and will take great solace in the fact that they are not alone, that they suffered the exact same fate as so many of their Facebook friends.

Being Open to Rethinking Presents Opportunities for Growth

Arrogant people and companies are unbending in their certainty. Their pride creates a sense of conviction, which can be an obstacle to experimentation and innovation. Theirs is the old way of thinking. Great leaders and organizations are often characterized by humility. They exhibit doubt, which leads to curiosity. They are unafraid of failure, eager to explore creative destruction. Humility can make them open to rethinking, leading to experimentation, learning and new discoveries.

At Pathfinder, we pride ourselves on taking fresh approaches to our business, walking away from tried-and-true formulas, and experimenting with new things. We've tried to instill this ethos in our team, and we've benefitted from performance that exceeded our expectations and new ideas that we'd not previously considered.

As we prepare to enter a new phase – with booster shots, offices reopening and more travel – perhaps now is good time to question some of our old assumptions and open ourselves to more rethinking.

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FINDING YOUR PATH

The Customer Service Conundrum

By Lorne Polger, Senior Managing Director

The Covid-19 epidemic has been hard on all of us. In our personal lives, we have faced extreme challenges relating to working from home, home schooling of our kids, increased social isolation, and unfortunately in some cases, illness, and death. In business, we have faced unforeseen and extraordinary challenges. Supply chain disruptions, employee shortages, safety challenges, ever changing rules and mandates. One of the victims? The customer service experience.

During the pandemic, I was involved in three situations where a vendor committed such an egregious act that they "lost a customer for life." There are lessons to be learned in each case.

Audi experience. In the summer of 2020, I was helping my daughter shop for a used car. In typical fashion for her, she had thoroughly researched the models, costs, and reviews, and had narrowed the field down to a couple of cars in a few selected colors. Given the dramatic shortage of used vehicles, this was no small feat (she must have picked this talent up from her dad, a notorious car buying-aholic!).

Low and behold, she found exactly what she was looking for. A low mileage Audi SUV in the perfect color combination! She spoke with the salesman a couple of times on the phone and then brought me in on the third call to close the deal. We agreed on a price and then discussed the logistics. The dealer was in the L.A. area (Audi of Ontario), my daughter was in Colorado, and I was in San Diego, so we had to figure out how to transact virtually, a new normal during the pandemic.

The dealer said they couldn't deliver the car to me in San Diego. The explanation did not make a lot of sense, but okay. When it came time to discuss the financing (I was fronting the money for my daughter until she could line up a loan), they also said they couldn't take a check from me. The explanation did not make sense; I had previously purchased many cars, including Audis, with a check, but okay. We ended up agreeing that I would send them a wire transfer on a Tuesday, and pick up the car the following weekend. The money was sent as agreed. My daughter was excited!

On Thursday, I received a call from the dealer telling me they sold the car to someone else that day. I was flabbergasted. I told them that I had wired them the funds, which they had received the day before. No apologies from them. When I questioned the general manager, he proceeded to insult me, and worse, refused to wire back the funds or pay for my wire transfer fees, saying they had a policy against that! As a three-time prior Audi owner and fan of the brand, I was outraged. So, I went into CEO mode and tried to make this a learning lesson for all involved.

I called Audi of America and spoke to a customer service representative. I relayed the story to them. The gentleman apologized and said they would delve deeply into the issue and get right back to me. Thankfully, I did not hold my breath, as I'm still waiting for the call back. Or at least an email. Or perhaps a telegram? Nothing. Crickets. Lost a customer for life. Audi sold 186,000 cars in the U.S. in 2020. You would think they would know better.

Delta Airlines experience. Recently, I booked a cross country flight. I'm a value investor and generally fly coach. However, given the long flight, the fact that I knew I was going to get a lot of work done on the flight, and a relatively small price difference between the classes, I decided to spend a few extra bucks, splurge, and fly first class. Yessiree, champagne and caviar for me aboard my Boeing! Okay, maybe Diet Coke and pretzels, but still,

sufficient leg and elbow room so that I could comfortably get some work done.

Low and behold, the afternoon before the flight, I received a text from Delta letting me know that there was a problem due to an aircraft change and I would be flying in coach instead. Middle seat. Five-hour flight. Okay, stuff happens, not the end of the world. But, what about the extra dollars I had dished out for first? The text message said nothing. I then went online to the Delta customer service portal. Nothing. As completely empty as you can get on the subject.

Okay, next up, the dreaded 1-800 number. In the "you can't make this up department", I was put on hold for 1 hour and 44 minutes. A new world record! Yippee!! When Theresa finally answered the line (with static, no less), she politely informed me there was nothing she would be able to do for me but thank you for flying Delta Airlines! I very politely asked that she speak to her supervisor about the matter. Another 20 minutes later, Theresa got back to me. "Good news, Mr. Polger. You will be able to process a refund for the fare difference after you complete your travel. You will just need to call this other 1-800 number and they will help you." I could not make this up if I tried. Lost a customer for life. Delta had $47 billion in revenue in 2019. You would think they would know better.

Restaurant experience. I started feeling comfortable dining in restaurants again by this spring, after I was fully vaccinated. This summer, my girlfriend and I dined with some friends in Denver. We decided on Del Frisco's in Cherry Creek, a nice, upper-end chain that was purchased by the behemoth entertainment conglomerate, Landry's, Inc. in 2019.

We were seated at our table as soon as we arrived. Great! After 20 minutes, no one had come by. And no menus had been provided. After waiving down (okay, by that time it was almost a tackle) a third person ("your waiter, Bob will be right with you…"), Bob finally came by to take our drink orders and even provided us with menus (there were no ubiquitous, scannable QR menus on the table). Okay, progress!

Another 30 minutes, and still no drinks. And no opportunity to order food. And it got worse from there. When the food was finally served (a little like waiting for Godot), they forgot my girlfriend's meal and our side dishes. Literally we had our food for 20 minutes and she was still waiting. Good 'ole Bob had disappeared. So, I took control of the situation. Went to talk to a manager. I assumed they were simply understaffed and overwhelmed. Not so, according to the manager! She said they were fully staffed, and everything was being handled properly! They eventually brought my girlfriend an undercooked piece of salmon in a to-go box, and instead of comping our meal or even offering dessert, they took the salmon off the bill. Lost a customer for life. Landry's had $5 billion in revenue in 2019. You would think they would know better.

What were the common themes among these three incidents? A general hubris about the lack of importance of the customer. A lack of understanding that the cost to acquire a customer is high, while the relative cost to keep them happy is relatively low. A lack of training; owners not training managers, and managers not training staff. And most importantly, a failure to empower employees to make decisions that provide a satisfactory experience for the customer.

While none of these examples involve Pathfinder's operations, I think about them in the context of our business. As a company, what can we do better to enhance our customer service experience?

Who are our customers? Well, we have several. First, our tenants, or as my friend Dick Michaux taught me a few years ago, our guests. Dick was the founder and CEO of Avalon Bay, one of the largest apartment REITs in the country. When Dick speaks, I listen. Have we empowered our property managers to make sure that our guests are satisfied living at our properties? Have we made it easy for them to pay their rent, to communicate with property staff, to have their repair orders addressed quickly and efficiently? Have we made the leasing application process seamless for them? Have we helped to create community at our properties? Are we listening to our guests' recommendations? What else can we be doing that we haven't thought of? And as a company, have we empowered our asset managers to provide the on-site property staff with the tools that they need to successfully navigate these issues?

Second, our investors. Are we delivering on our promises? Are we communicating clearly, thoughtfully, and transparently with them? Are we listening and responding to their questions and suggestions? How can we do better?

Third, our circle of business associates. This includes other owners that we transact with, our vendors, brokers, and service professionals. Are we following through on our promises? Are we responding to their requests in a timely and thorough manner? Do we return phone calls and emails promptly? What else can we proactively be doing to ensure their experiences with us are best in class?

Fourth, our staff. Have we empowered them to make the experience for those that they interact with a positive and professional one? In today's hybrid office environment, have we given them the necessary tools to be successful?

It's a challenging time in business. Talent shortages and supply chain disruptions will likely persist. From my perspective, now is the time to double down on empowering teams to enhance the customer service experience. It's an awful time to rest on laurels and be complacent. And you know, after living through the nightmare of the last 18 months, we all deserve to be treated well!

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GUEST FEATURE

Putting Higher Interest Rates into Perspective

By Scot Eisendrath, Managing Director

I'm guilty. Over the past few years, I've been following interest rates pretty closely. Of course, being financially minded and in real estate I've always paid attention to where rates are and where the pundits think they may be headed, but if you ask me today where the ten-year treasury rate is, I will know within a few basis points.

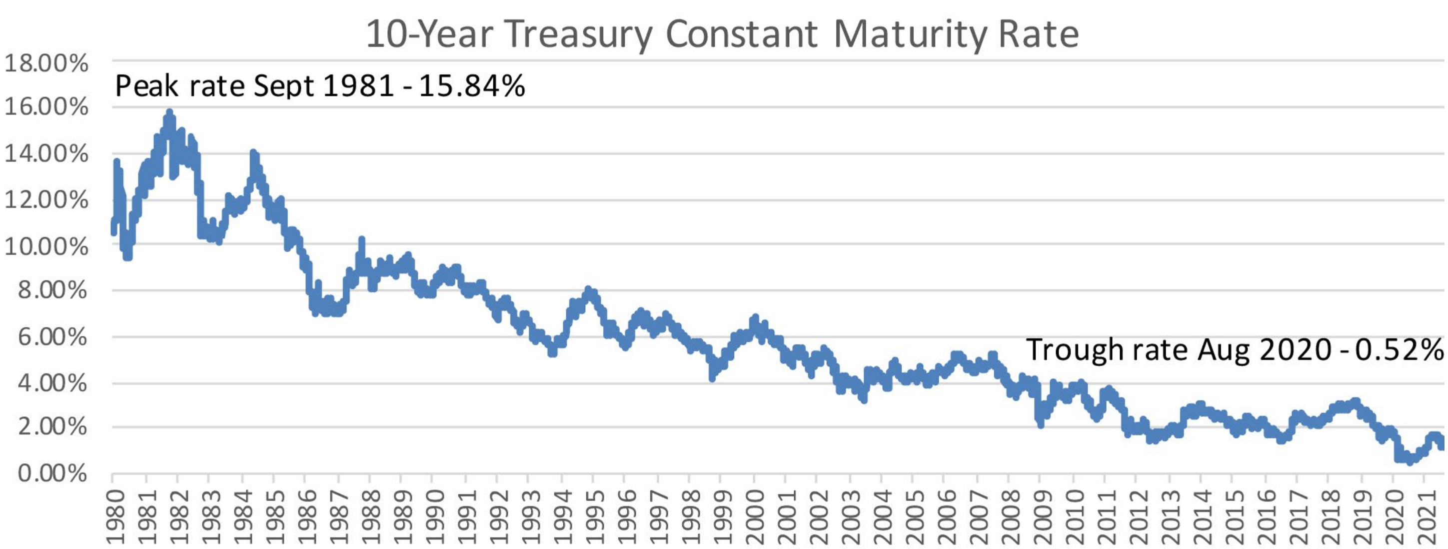
I wouldn't call it an obsession, but I've gotten into the habit of seeing where the ten-year treasury yield to maturity is each morning and then again at the end of the trading day. Okay, maybe once more before going to bed I'll take a quick look at the after-hours quotes to get a feel for where treasuries will open the next day – who doesn't like to get a head start on tomorrow! It's been an interesting run and there has been plenty of excitement and volatility.

Why have I paid such close attention to interest rates? We've been busy at Pathfinder placing financing on new acquisitions, refinancing some properties, and selling others. Our buyers are dependent on the debt markets and cheaper debt for them translates to higher values for our investors. It's been a great time for multifamily investors to take advantage of historically low long-term rates. In fact, our financings during the past year have featured seven- to ten-year loans at fixed rates in the 2.5% to 3.0% range. Nothing to complain about there!

While I'm more than a casual observer, the media and financial markets are downright obsessed with movements in interest rates. I realize that rates have a significant impact on the general economy and directly impact many things – like the general cost of funds, the discount rate underlying the net present value of future corporate earnings, fixed incomes for pensioners and borrowing rates for real estate purchases, credit card balances, corporate bonds and more. But when rates move ten or twenty basis points in a week at these relatively low levels, it's really not the end of the world, and needs to be put in perspective.

The NASDAQ, comprised primarily of high-flying technology stocks, dropped nearly 6% in September, primarily attributable to rising interest rates; the benchmark ten-year treasury rate rose during the month from 1.31% to 1.54%, a 23-basis point (18%) increase. I was taught that higher interest rates normally indicate that the economy is heating up (unless, heaven forbid, we get hit with Japan-like stagflation). Who wouldn't be happy with an improving economic picture?

Enlarging our scope, consider that the ten-year treasury rate moved from 0.93% last December to about 1.60% earlier this month. Pretty big move, more than 70%. But let's put that into perspective. We've had a 40-year bull run in the bond markets. The ten-year treasury rate



Source: Board of Governors of the U.S. Federal Reserve System peaked in September 1981 at 15.84% (see graph below) so it's down about 90% over the past four decades. In the four years from 1977 to 1981, the yield on long-term corporate bonds nearly doubled – from 7.92% to 15.49%. Now that's a big move, fast! I've heard the horror stories about 18% mortgage rates, and in fact, my first mortgage in the mid-1990's was in the 8% range.

I'm concerned about increasing interest rates and their effect on the economy and asset values, but at some point, rates need to rise, and I think gradual increases would be healthy for the financial markets. Sure, our borrowing costs will rise, but if we're still borrowing in the 3% to 4% range, that's fantastic, and if rates have risen to that level, it likely means the country is prospering and our economy is humming along.

In the meantime, my investment advice is to be cautious about owning bonds/fixed income securities as rate increases are likely, which wouldn't be good for the value of these securities. And, on the other side of the ledger, consider taking advantage of these long-term, historically low rates by locking them in for the long haul. We may never see rates this low again.

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ZEITGEIST – NEWS HIGHLIGHTS

New Study Outlines Benefits of Pet-Friendly Apartments

The "Pet-Inclusive Housing Initiative Report," published by the *Michaelson Found Animal Foundation* and the *Human Animal Bond Research Institute* quantifies some of the benefits of pet-friendly communities. The key takeaways include:

- Residents in pet-friendly housing are more satisfied and remain in the housing 21% longer than those in properties which do not allow pets.
- Pet-friendly housing fills a market need – 72% of residents reported difficulties in finding pet-friendly housing.
- 83% of owners and operators reported that pet-friendly vacancies are filled faster.
- Properties without pet-friendly policies cause dissatisfaction with residents, 35% of whom say they would get a pet if their landlord allowed it.

The data confirms what many landlords know: that pet-friendly apartments see less turnover (reducing costs) and often have more stable, happier residents. Pet rent – the standard monthly fee that landlords charge their tenants for each pet – can also meaningfully increase an apartment's ancillary income. The report also outlined the protections landlords can put in place, including a screening process that focuses on lower-risk and more well-behaved breeds and deposit structures which can protect landlords from pet damage.

(Editor's Note: Pathfinder has long-been an advocate of pet-friendly communities and all our apartment properties allow pets with varying restrictions on breed, size and number. We're also big advocates of the "Bark Park" – a great place for residents to socialize while Fluffy gets her exercise – "Yappy Hours", where residents and their pets can socialize and community-wide pet contests with prizes.)

Material and Labor Shortages Exacerbate the Housing Crisis

Since the start of the Covid-19 pandemic, the National Multifamily Housing Council (NMHC) has been surveying leading multifamily construction firms to help the industry gauge disruptions and track market conditions. In a survey conducted between August and September 2021, a record 98% of respondents said they have been impacted by a lack of building materials to make necessary repairs and 100% reported price increases on materials.

Furthermore, 88% of respondents reported difficulties finding labor and 54% responded that labor was difficult to find even after increasing wages. Of the firms that raised compensation to attract or retain laborers, the average reported increase was 12%.

The increases in material and labor costs (coupled with long-standing challenges in obtaining entitlements) has further hindered the ability of developers to deliver new and affordable housing to meet demand. According to Doug Bibby, NMHC president, "today's data underlines the deep challenges that developers continue to face almost a year and a half after the onset of the pandemic." Bibby further states that, "Steps must be taken to increase the supply of labor across the country and bring material costs back to reasonable levels."

There is light at the end of the tunnel as the ripple effect from the extended unemployment benefits is expected to wane and begin to move labor levels back towards equilibrium. There are an estimated 500,000 shipping containers waiting off ports in Los Angeles and Long Beach due to shortages in truck drivers and dock laborers, among other factors. Hopefully, a resolution of the labor shortage can partly alleviate these material delays.

TRAILBLAZING: RED HAWK, CASTLE ROCK (DENVER), CO

"Small Town America in the Colorado Foothills"

A recent national survey by *Ipsos* – a global market research firm – found that since March 2020, nearly half of Americans, 49%, have moved or considered moving. The top relocation choice was suburban areas (22%) – a trend Pathfinder has monitored closely while scouting investment opportunities during the pandemic.

In October 2020, we purchased The Highlands at Red Hawk ("Red Hawk"), a 56-unit apartment community in Castle Rock, a quaint town 30 miles south of downtown Denver and 35 miles north of Colorado Springs. We believe Castle Rock offers an ideal setting for those seeking a slice of small-town Americana. We weren't alone: last year, Castle Rock was named the Nation's top "Up-and-Coming Small City Close to a Major Metro" by *Livability*.

Castle Rock is known for its charming downtown district, safe neighborhoods, award-winning public schools and a recreation system featuring 50 parks, 87 miles of trails and over 6,000 acres of open space. Over the past decade, Castle Rock has been recognized frequently for its exceptional quality of life. This year, the town was ranked one of the "Safest Cities in Colorado"

Redhawk – Building Exterior

Redhawk – Kitchen

by *SafeWise* and one of the "Best Places to Live in the U.S." by *Money Magazine*.

Between 2010 and 2019, Castle Rock experienced population growth of 45%, growing to 75,000 residents. And they're affluent (an average annual household income of $128,000) and educated (95% have high school degrees and more than 80% have attended college).

Red Hawk, built in 2017, is situated on a five-acre parcel and includes a mix of one-, two- and three-bedroom apartments averaging 1,064 square feet – exceptionally large by traditional multifamily standards. The property was built by a local homebuilder and has features more commonly found in for-sale homes. Each unit comes with a one-car, direct access garage, electronic key fob entry, 9′ ceilings, fully equipped kitchen with stainless steel appliances, full size washer/dryer, fireplace, walk-in closet and private patio or balcony. The property features a clubhouse with a game room, coffee bar, Wi-Fi, 24-hour fitness center, dog wash and a swimming pool.

Red Hawk's residents are only a five-minute drive to The Promenade at Castle Rock, a 166-acre upscale retail center (one of the largest in the country) and a 15-minute drive to Denver Tech Center, the largest employment center in metro Denver. Red Hawk residents enjoy the convenience of these local amenities while living in a family-friendly environment amongst the beauty of the Colorado foothills. Talk about having your cake and eating it too.

Castle Rock, Colorado: Did you know?

Miller's Landing: Through a public and private partnership with the town of Castle Rock, P3 Advisors is transforming what was once a contaminated parcel into Miller's Landing – a dynamic, sustainable, 65-acre mixed-use development. The project is located at the eastern edge of Phillip S. Miller Park and will feature a pedestrian and bicycle friendly town center with hospitality, entertainment, retail and office uses. Phase 1 will be completed in 2022 with the remaining build-out completed over the next decade.

Rendering of Miller's Landing

NOTABLES AND QUOTABLES

Collaboration

"In the long history of humankind, those who learned to collaborate and improvise most effectively have prevailed."

- Charles Darwin, *English Scientist*

"Coming together is a beginning, staying together is progress and working together is success."

- Henry Ford, *American Businessman*

"Not finance, not strategy. Not technology. It is teamwork that remains the ultimate competitive advantage, both because it is so powerful and rare."

- Patrick Lencioni, *American Writer*

"There is no such thing as a self-made man. You will reach your goals only with the help of others."

- George Shinn, *American Businessman*

"Teamwork is the ability to work together toward a common vision. The ability to direct individual accomplishments toward organizational objectives. It is the fuel that allows common people to attain uncommon results."

- Andrew Carnegie, *Scottish-American Businessman*

"Individual commitment to a group effort – that is what makes a team work, a company work, a society work, a civilization work."

-Vince Lombardi, *American Football Coach*

"The strength of the team is each individual member. The strength of each member is the team."

- Phil Jackson, *American Basketball Coach*

"There is immense power when a group of people with similar interests get together to work toward the same goals."

- Idowu Koyenikan, African Author

"Unity is strength. When there is teamwork and collaboration, wonderful things can be achieved."

- Mattie Stepanek, *American Poet*

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