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THE PATHFINDER REPORT

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IN THIS ISSUE

CHARTING THE COURSE

Living in Your Parents' Basement

By Mitch Siegler, Senior Managing Director

We attended our youngest's college graduation earlier this month. Our daughter earned a double major, with honors, from UC Santa Barbara and now embarks on the next chapter in her great life adventure. She's smart and savvy, hard-working and personable and we know she's going to be a great success. She's now well on her way and completely off her parents' payroll!

But that's not the story for every Gen Z'er (aka Zillennials, those born 1996-2010 – the older segment of this cohort is aged 22-27) or Millennials (those born 1981-1996 – the younger segment of this cohort is aged 27-32). These young adults, especially those in their early-20s to mid-30s, are setting a record – for moving back in with their parents. And many don't seem to be in a great hurry to move out!

A 2021 *Pew Research Center* study found that 25% of U.S. adults aged 25 to 34 were living in a multigenerational home; in 2011, just 20% were. In 1971, the number was only 9%. The number of "boomerang" kids has declined a bit since the 2021 pandemic-related peak but not much – last year, 19% of 25-34-year-old men and 12% of women were living with their parents. A 2022 poll by the Harris poll, commissioned by Daily Pay, a financial services company, had a startling find: 54% of Gen Z are *choosing* to live with their parents.

The reasons abound. While inflation and economic stress are driving the trend, there are various other contributing factors. The pandemic was certainly a catalyst – a Zillow analysis found that 2.7 million U.S. young adults moved in with a parent in March or April 2020. And it can be challenging to relaunch: We've seen research suggesting that two-thirds of pandemic-era boomerang kids are still living with Mom and Dad. But Covid-19 is now in the rearview mirror and lots of young people are still camped out at home, raiding the pantry, and using up the laundry detergent. What gives?

Today, we still have several demographic, societal and economic trends contributing to the rising number of young people living with their parents. Much has been written about younger people delaying marriage and family formation. The younger generations are having fewer children (if they have any at all) and are more content renting an apartment as compared with purchasing a home. As a society, we're not as excited about ownership as previously – be it a car, primary residence or vacation home. This trend is particularly pronounced with younger people, some of whom are content to leverage their parents' washers and dryers rather than schlep to the laundromat. Some generous parents foot the bill for groceries and charge no rent, allowing their kids to pay down debt and boost savings.

Who says there's no free lunch?

The consumer website Savings.com found that 62% of adult children living with parents "don't contribute at all to the household expenses." Some parents have themselves to blame. Kids who were enabled in an era of participation trophies may not feel the need to carry their end of the log. Data showing that 10% of adult children still collect an allowance drives home that point!

It's one thing for a directed young person to live at home, save money, repay debt, and prepare to relaunch. It's been a challenge these past few years with the pandemic and high inflation is another financial obstacle. It's quite another matter to fail to launch because junior just doesn't want to go out and get a job.

It's tough out there.

At first blush, the economy looks strong. After all, the unemployment rate is at a 40-year low. However, many jobs are lower-paying, service positions and it's tough to pay the bills on $15-$20 hourly wages – which leaves little left over after restaurant meals, bar tabs and travel.

There's certainly not much remaining for savings in an era of dreadfully low home affordability. While it costs much less to rent than to own (35%-60% less, depending on apartment type, in Pathfinder's markets), renting is also out of reach for many in more expensive, coastal cities for those with lower incomes – even if they are doubled up. Living with mom and dad allows a young person to save money but returning from college to the old twin bed is probably no walk in the park for most 20- and 30-somethings.

When interviewed, some young adults admit they're just not ready to "adult". Nada Torbica, a 23-year-old from Boca Raton, FL who graduated in 2022 with a degree in Industrial Engineering from the University of Florida, listed the pros of living at home in a TikTok video that hit nearly a million views: "You work to save 100% of your paychecks. Free meals, can spend paychecks on traveling, get to live with family dog, no real adult responsibilities."

Not all parents are thrilled with it.

Some parents are thrilled to have their kids back at home. My wife and I enjoyed having our son, 25 at the time, with us during the pandemic summer of 2020. All good things must come to end; after three months, we all agreed that it was time for him to return to L.A. to his own apartment.

A December 2022 *Pew* survey found that 40% of dads believe parents hosting adult children is bad for society while only 12% think it's a good thing. Moms concur – to a lesser extent. (For those of you looking to bone up on this issue or to prepare for challenging conversations ahead, there are lots of online resources and articles, including this gem: "How to Get Your Grown Children to Move Out.")

There are larger forces at work.

Most young people would prefer to be independent just like most parents got used to being empty nesters and aren't pining to return to setting the ground rules or another place at the dinner table. If these living trends were driven by strong multigenerational factors, like one sees in Europe, it would be one thing. But that's not really what's at work. The recipe behind this seems to be three parts economic pressures, one part convenience (laziness?) with a few sprinkles of parental enabling.

One thing seems apparent: millions of young people living with their parents is a coiled spring for the housing market – when these kids finally move out next month or next year, they'll create considerable additional demand for apartments.

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. He can be reached at msiegler@pathfinderfunds.com.

FINDING YOUR PATH

A Summer's List

By Lorne Polger, Senior Managing Director

Historically, the summer season has been a bit slower for Pathfinder. Most of our industry deal makers head to the hills or the oceans at various points in July and August to spend time with family and recharge the batteries. This is especially true this year as deal volumes across the commercial real estate spectrum have fallen off the proverbial cliff, waiting for the wide gap between bid and ask pricing to narrow and for the markets to settle back down. More on that in September's newsletter…

I've been a voracious reader, although these days, it occurs most often in the first couple of hours of each morning as I digest a daily breakfast of various business and real estate periodicals with my coffee, as opposed to the evening reading ritual that I used to regularly partake in. But during this slower summer period, I thought I would compile a list of some books that have been most meaningful to me, both personally and professionally, over the years. I've gone back and reread some of them in the past and am planning to do so again this summer. Feel free to grab one off the shelf (okay, Amazon will have it to your house within an hour or two, or less if you're a Kindle reader) and feel free to email me your recommended list. I'm happy to share it. Without further ado, here's my top ten:

The Sun Also Rises, Ernest Hemingway (1926). Inspired by Hemingway's trips to Spain, a novel that portrays American and British expatriates who travel from Paris to a festival in Pamplona to watch the running of the bulls and bullfights. *The Sun Also Rises* is about being uncomfortable in things that should be easy: the action of bullfighting, trust in friendship, relief in a stiff drink, etc. The book focuses on the lives and interactions of people who are constantly seeking fulfillment and happiness in fleeting things. It was the first of Hemingway's books that I read. Although not my favorite (that was *The Old Man and the Sea*), it turned me on to the richness of his words. I subsequently read all his works. Particularly timely today, especially with this passage: "How did you go bankrupt?" Bill asked. "Two

ways," Mike said. "Gradually and then suddenly." This, known as **Hemingway's Law of Motion**, is startingly applicable to distressed projects.

The Grapes of Wrath, John Steinbeck (1939). My favorite author and arguably Steinbeck's seminal work, the novel evokes the harshness of the Great Depression and arouses sympathy for the struggles of migrant farmworkers. The book is rooted in the historical and social events of 1930s America, focusing on the impoverished and dispossessed who come together to gain power against capital-minded owners. Humans finding strength in group unity and action is a message that still resonates with me today. I enjoyed many other works by Steinbeck, including *Of Mice and Men* and *East of Eden*, but Grapes remains my favorite.

1984, *George Orwell* (1949). Orwell wrote this book as a warning after years of observing the twin menaces of Nazism and Stalinism. Its depiction of a state where daring to think differently is shunned, where people are continually monitored, and where party propaganda trumps free speech and thought is a sobering reminder of the evils of unaccountable governments. We still talk of Big Brother today, almost 75 years after this book was written. The main character's defeat in trying to question the actions of the government is a reminder of the vulnerability of such values amid all-powerful states.

On the Road, Jack Kerouac (1957). A novel by the preeminent Beat Generation writer recalls Kerouac's cross-country travels across the U.S. in the late 1940s. It explores concepts of society, freedom, life on the open road and – most of all – friendship. When I first read this in high school, it spoke to me in the context of getting out of my own comfort zone, increasing my *joie de vivre* (living in the moment) and free spirit. I loved all the

characters and delved further into them with separate readings about Neal Cassady and Allen Ginsburg.

Portnoy's Complaint, Philip Roth (1969). A journey through the neurosis of Alexander Portnoy, told through his one-way dialogues with his therapist. Stories of family, ethnicity, coming of age and sexuality are both painful and hysterically funny. My favorite work from this Pulitzer Prize-winning author.

The Godfather, Mario Puzo (1969). Before there was the movie, there was the book. The multigenerational tale of the Corleone family, the novel spawned two films that won the Academy Award for Best Picture in 1973 and 1975. From my perspective, there's been nothing like it since. I can quote most of the lines from the original film still. I've watched it too many times to count.

One L, Scott Turow (1977). *One L* tells author Scott Turow's experience as a first-year Harvard law student. Turow recounts his time there, the professors and classes that helped mold him into the lawyer and writer that he became. I started law school in 1985 and this book was pretty much required reading for most of us back then. The focus on the competitiveness of the students and the quirkiness of the professors was both enlightening and intimidating. Fortunately, my experience at UCLA was quite a bit mellower; I guess that was one of the differences between Boston and L.A.

A Man in Full, Tom Wolfe (1998). Probably my second favorite author (I've also read all his works), this novel set primarily in Atlanta, details the rise and fall of a prominent local real estate developer. Having lived through real estate up and down cycles with my family's business, with my clients when I was a lawyer, and then with Pathfinder, I hung on to Wolfe's every word. But I'll never forgot the scene Wolfe depicts with the bank's special asset officer leaning over the conference table dressed in skull and cross bone suspenders berating his delinquent borrower. I'm always reminded of this when I hear borrowers describe their lenders as their partners.

Good to Great, Jim Collins (2001). Analyzing 28 companies in three categories – good-to-great, direct comparison and unsustained comparison – over the span of 30 years, Collins and his team looked at companies which went from average or sub-par stock market performance to outperforming the market by a factor of three or more. The result is a set of strategies, habits, and practices which can turn a company from good to great. I first read this when I was aggressively building my law practice and have turned to it several times since. Recommended reading for anyone wanting to successfully grow a business.

Principles, Ray Dalio (2017). The most recent one to hit my top list, my partner Mitch gave me this book a few years ago and I've read parts of it over a few times since. Dalio is one of the most successful investors and hedge fund managers in the U.S. The book teaches that building a great organization is about having great people and a great culture, and having the machines to ensure your outcomes consistently match your goals. He believes that you need to align your work with your passions, and to do it with people you want to build a future with. I believe we've accomplished that mission at Pathfinder over our 17 years.

I hope that you'll have the opportunity this summer to kick back a bit and enjoy reading (or in some cases, re-reading) at least one of these classic books. And appreciate how the written word continues to stand the test of time.

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GUEST FEATURE

What's the Plan for Downtown?

By Matt Quinn, Vice President, Asset Manager

In Petula Clark's 1968 classic "Downtown", she sings: "When you're alone and life is making you lonely you can always go (dramatic pause) Downtown!".

In a post-pandemic downtown – where office vacancies have soared, public transit ridership has plummeted, crime has spiked and homelessness and drug use are often shockingly public – Petula's lyrics are sounding dated. Across the nation's ten major metros, offices are only 50% as full as before Covid and public transit ridership is less than 70% of pre-Covid levels. Downtown San Diego's homeless population recently hit 2,000 – an all-time high – and cities across the U.S. are struggling to manage downtown homeless populations and the associated encampments and human waste.

The share prices for the five largest real estate investment trusts (REITs) that focus on downtown office buildings are down more than 60% since 2019 and City budgets are stressed as office building values continue to decline (office building property taxes account for about 10% of revenue in major metros). The situation is being aggravated by rising interest rates which are increasing monthly debt payments for owners with variable rate loans, while in parallel, revenue is declining due to lower occupancy. This combination has created a perfect storm for office loan defaults. Brookfield Asset Management – one of the world's largest alternative asset management firms – recently defaulted on $2 billion in CMBS loans tied to downtown office buildings. Twitter is no longer paying rent at some of its downtown San Francisco offices while its owner, Elon Musk, signals its headquarters will be moving and that downtown San Francisco feels "post-apocalyptic".

With a growing number of corporations relocating to lower density areas and many white-collar workers still working from home, residential neighborhoods are reaping the rewards. These quasi-urban areas with medium density apartments, restaurants, retail and bars are benefiting from the business and population migration out of downtowns into safer and still vibrant neighborhoods. In San Diego, think of North Park, Carmel Valley or La Mesa. In Phoenix, it's Gilbert or Tempe and in Denver it's Sloan's Lake or Highland. The pandemic's lingering effects on downtown offices has withdrawn the human energy from the skyscraper-laden financial districts and deposited it into smaller urban neighborhoods with safe places for people to work, relax, eat, drink, shop, exercise and connect.

In Downtown Los Angeles, foot traffic is less than 70% of pre-pandemic levels. The folks representing the missing 30%+ are still walking *somewhere* but they've likely shifted their preferences towards walking in a safer location, closer to home. In Chicago, downtown offices, which accounted for more than 80% of corporate lunch orders at *Grubhub* in 2019, represent only 60% in 2023. The missing diners are probably not newfound advocates of intermittent fasting but are working from home and eating at their neighborhood deli (or kitchen table). In Pathfinder's office park, the office-worker-focused sandwich chain, Specialty's Café, closed when the company went bankrupt during Covid and has yet to be replaced. For a while, I was forced to make my own sandwiches (they were delicious) but I've since discovered alternative deli options in neighboring office parks.

Meanwhile, it seems like every mayor in the U.S. has a different plan to aggressively activate or revitalize their city's downtown. In Seattle, Mayor Harrell recently announced a set of "immediate actions to make downtown neighborhoods safe, welcoming and active" and branded it "Downtown is You." The list of actions is noble – activate parks, fight homelessness, bring workers back downtown – but the A.I.- generated illustrations of the future "activated" downtown look starkly different from the existing images of empty office buildings and graffiti. These new visions for downtowns often seem too perfect and don't accept the reality that some things may have changed permanently.

Are downtowns dead forever? No, the pendulum will swing back (or may swing back), but white-collar workers are now acutely aware that they can work from home and it's something they'll not soon forget. If I was consulting for these mayors, my advice would be to approach the plan like a real estate investor underwrites a new acquisition: assume a reasonable and conservative future occupancy level – for downtown office, perhaps it's 60-70% of pre-Covid levels – and craft your plan around that. You might not hit a home run but your investors – or constituents, in this case – would probably be very happy with a single or double.

Matt Quinn is Vice President at Pathfinder Partners, focusing on asset management activities. Prior to joining Pathfinder in 2009, Matt worked with a San Diego-based firm which consulted on mergers and acquisitions and with the Wealth Management division of a California regional bank. He can be reached at mquinn@pathfinderfunds.com.

ZEITGEIST – SIGN OF THE TIMES

America's Housing Mismatch

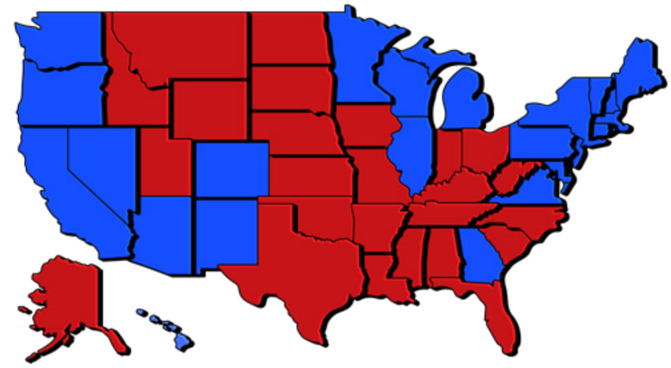
Since the start of the 21st century, it has become increasingly common for Americans to live alone. As of 2020, single-person households represented 27% of the population, up from 7% in 1940. From 2010-2020, 44% of U.S. household growth was contributed by sole-person households. This trend's most notable housing consequence is the increasing mismatch between the existing housing stock – lots of single-family homes built for families – and more Americans living alone and needing less space.

To make matters worse, Gen Z – Americans born between 1997-2012 – represents more than 20% of U.S. renters and is forecasted to be the largest renter cohort by 2030. Since Gen Z renters are younger and, like Millennials, often delay marriage, many are choosing to live alone, further exacerbating the housing mismatch.

In response to this trend, developers are gravitating toward smaller housing options including one-bedroom apartments, studios and micro-units. Also, state governments – most recently California, Maine and Oregon – are amending their single-family zoning mandates to address the gap between single-family homes and high-rise apartments. Supporters of these new zoning laws cite affordability, racial equity and climate change (more density means less reliance on cars) as positive outcomes.

Existing homeowners generally oppose these laws as they fear traffic, parking issues and a degradation of their neighborhoods' character. Many of these laws are facing opposition from constituents. One, California's controversial SB-10 – which allows local governments to zone up to ten homes per single-family parcel in transit areas – has yet to be adopted by any cities in the State.

Today, nearly two-thirds of American households are just one or two people. As our nation battles a widely publicized housing affordability crisis, it's also fighting a much-less-discussed housing mismatch crisis.



From Blue to Red

The U.S. Census Bureau's recently released 2022 migration data shows a trend of accelerated migration from blue states to red states. California lost the most residents from outmigration (-343,000), followed by New York (-300,000) and Illinois (-142,000). Meanwhile, the three states with the most in-bound migration include Florida (+319,000), Texas (+231,000) and North Carolina (+100,000). For the first time since 1957, Florida had the fastest growing population of any state with an annual population increase of 1.9%.

To quantify the fiscal impact for states, the IRS publishes data on the movement of taxpayers by level of adjusted gross income (AGI) across state-lines each year. In 2021, the average AGI of individuals who moved to Florida was about $150,000, more than double the level of those leaving. The taxpayers leaving Illinois and New York typically made $30,000-$40,000 more than those arriving. Nearly a quarter of the individuals leaving Illinois made $200,000 or more.

The influx of high-income earners increased Florida's AGI in 2021 by $39.2 billion – up from $23.7 billion in 2020 – with approximately $9.8 billion coming from those arriving from New York (which lost $24.5 billion AGI in 2021). Texas was another big winner with an additional $10.9 billion in AGI with more than half of the gain coming from those arriving from California. California's total AGI loss in 2021 was -$29.1 billion, more than triple 2019's figure. With higher income earners leaving blue states and lower income earners arriving, these migration patterns will have a meaningful impact on state budgets for years to come.

TRAILBLAZING: LAS PALMAS, SAN DIEGO, CA

"A Slice of Urban Solace"

The majority of San Diego's apartments are small properties (less than 50 units) built before 1980. These older apartments are prevalent in San Diego's Mid-Cities submarket, adjacent to downtown, and known for its mix of single-family homes, small apartments and quaint retail. This submarket has experienced historically low vacancy and robust rent growth (3% and 13%, respectively, in 2022). The Mid-Cities neighborhoods are rich in character and provide some of San Diego's most desirable urban living environments.

In February 2020, we purchased Las Palmas, a 1940's-vintage apartment community in the Mid-Cities neighborhood of Talmadge, six miles east of downtown. Las Palmas was our fifth acquisition in Pathfinder Tradewinds Opportunity Fund I, which acquired ten smaller, value-add apartment properties in San Diego County.

Las Palmas – Community BBQ Area

Las Palmas – Renovated Kitchen

Talmadge is a quiet neighborhood located one mile from San Diego State University with convenient access to the employment and entertainment centers of Mission Valley and downtown. Talmadge is adjacent to the affluent community of Kensington (median home price of $1.6 million) where residents enjoy a public park, a library and several cafés, restaurants and bars. The charming character of these neighborhoods appeals to young professionals and families who appreciate a walkable, urban community without the density associated with downtown.

Las Palmas is a 36-unit, garden-style community with two-bedroom apartments averaging 833 square feet (spacious for the submarket). The property is situated on a large, 1.7-acre lot and features historic, Spanish-style architecture in seven two-story buildings. Large grass areas with mature trees separate the buildings and provide a park-like setting. The property includes 21 garages and 24 surface spaces.

Pathfinder purchased Las Palmas in an estate sale; the previous owner had owned the property for more than 20 years and spent very little on improvements. We have installed new windows, painted the buildings, added a community space with a BBQ and fire pit, installed community gardens and live-monitoring security cameras and made repairs to the roofs and garages. We renovated 35 of 36 apartments installing washers and dryers, refinishing the original hardwood floors and modernizing the bathrooms and kitchens.

Last month, we completed construction of three accessory dwelling units (increasing the unit count from 36 to 39) by converting three free-standing laundry buildings into studio casitas with private patios.

At Las Palmas, residents enjoy a slice of urban solace in a low-density community within a charming and highly walkable San Diego neighborhood.

Las Palmas – Accessory Dwelling

Talmadge (San Diego), CA: Did you know?

Talmadge was established in 1925 and named after the silent movie stars Norma, Natalie and Constance Talmadge. The development of the neighborhood was largely funded by the president of United Artists, who was married to Norma. The sisters hosted a dedication ceremony in January 1926 and over 10,000 people attended including Buster Keaton, Natalie's husband and one of Hollywood's biggest stars. Today the population of Talmadge is approximately 10,000 – near the number of people that attended the original opening ceremony. Many historic homes still exist in the neighborhood in architectural styles including Spanish Revival, California Bungalow and Craftsman.


Talmadge – 1926 Opening Ceremony

NOTABLES AND QUOTABLES

"Optimism"

"When it rains, look for rainbows. When it's dark, look for stars."

- Oscar Wilde, *Irish Poet and Playwright*

"Instead of worrying about what you cannot control, shift your energy to what you can create."

- Roy T. Bennett, *American Author*

"Believe you can and you're halfway there."

- Theodore Roosevelt, *American President*

"One of the things that I learned the hard way was that it doesn't pay to get discouraged. Keeping busy and making optimism a way of life can restore your faith in yourself."

- Lucille Ball, *American Actor*

"If you try to send out good things, good things come back to you."

- Jan Brett, *American Illustrator*

"Optimism is the most important human trait because it allows us to evolve our ideas, to improve our situation and to hope for a better tomorrow."

- Seth Godin, *American Author*

"Now is no time to think of what you do not have. Think of what you can do with what there is."

- Ernest Hemingway, *American Author*

"A pessimist sees the difficulty in every opportunity; an optimist sees the opportunity in every difficulty."

- Winston Churchill, *British Prime Minister*

"Optimism doesn't mean that you are blind to the reality of the situation. It means that you remain motivated to seek a solution to whatever problem arises."

- Dalai Lama, *Spiritual Leader of Tibetan Buddhism*

IMPORTANT DISCLOSURES

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