Volume 33, No. 1, April 26, 2019

Quarterly Update

CWS Capital Partners LLC

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CWS

CALENDAR OF EVENTS

May 27, 2019
Memorial Day Holiday
CWS Offices Closed

June 17, 2019
2nd Quarter 2019
Est. Tax Payments Due

July 4, 2019
Independence Day Holiday
CWS Offices Closed

July 26, 2019
2nd Quarter 2019
Quarterly Packages Mailed

September 2, 2019
Labor Day Holiday
CWS Offices Closed

September 16, 2019
3rd Quarter 2019
Est. Tax Payments Due

October 15, 2019
2018 Tax Return Extensions Due

October 25, 2019
3rd Quarter 2019
Quarterly Packages Mailed

50 CWS Enhancing Lives Years

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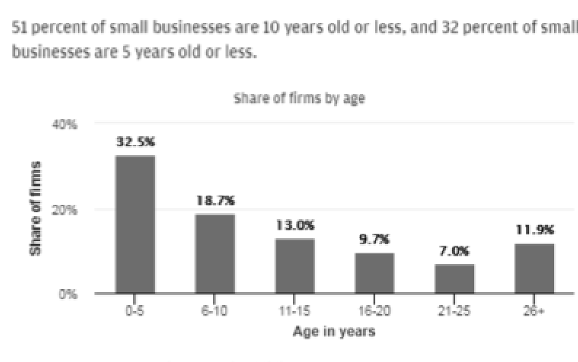
50 Years And Still Going Strong

By Gary Carmell

The following is an excerpt of my presentation at CWS' annual investor meeting.

2019 is CWS' 50th year. This is quite an accomplishment and worthy of celebration. To put this achievement in context, I did some research in terms of the lifespan of typical businesses in the United States. As the following charts and tables show, there's an approximately 50% chance that if one were to start a business today that it would still be around in five years and after 25 years that



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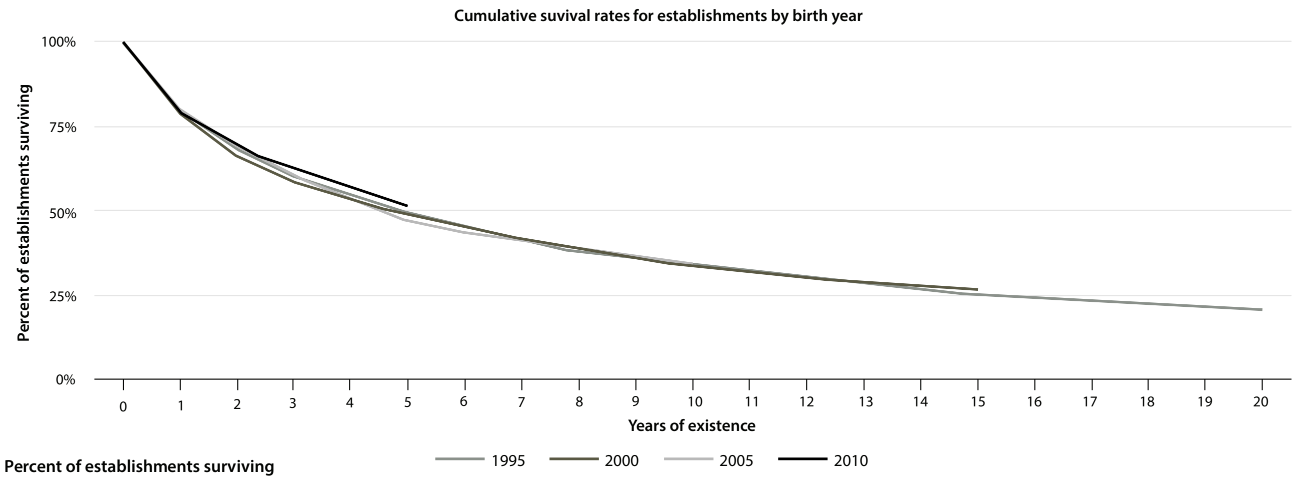
The survival rate of new businesses has been remarkably consistent over time.



would drop down to approximately 12%. So one can imagine that 50 years is a lot smaller of a probability and a business such as CWS is indeed in rarefied air. What has enabled us to be able to survive and prosper over this period of time? I think it goes back to Bill Williams and Jim Clayton starting off by raising money from friends and family and the tremendous responsibility that goes along with that. They are highly competitive people who do not like to lose and this translated to them having a fierce commitment to not losing their investors' money. It continued after Steve Sherwood joined Bill and Jim and remains central to how we operate the business today. It is embedded in our DNA and our culture to do everything in our power to preserve the capital that has been entrusted to us. Only after we feel like we understand the downside can we then focus on the upside. Many firms who have not been as fortunate as CWS learned the hard way that they had it backwards and did not truly understand or care to acknowledge the risk they were bearing.

Roughly a third of new businesses exit within their first two years, and half exit within their first five years.

New businesses that exit within...

1 year	21.4%
2 years	31.4%
3 years	38.4%
4 years	44.0%
5 years	48.9%

Note: Figures represent survival rates for businesses started in 2010

Source: Bureau of Labor Statistics, Business Employment Dynamics

What have been some of the important ways we have tried to manage risk? There's a relatively easy recipe and a much harder one. I will start with the "easy" one but realistically,

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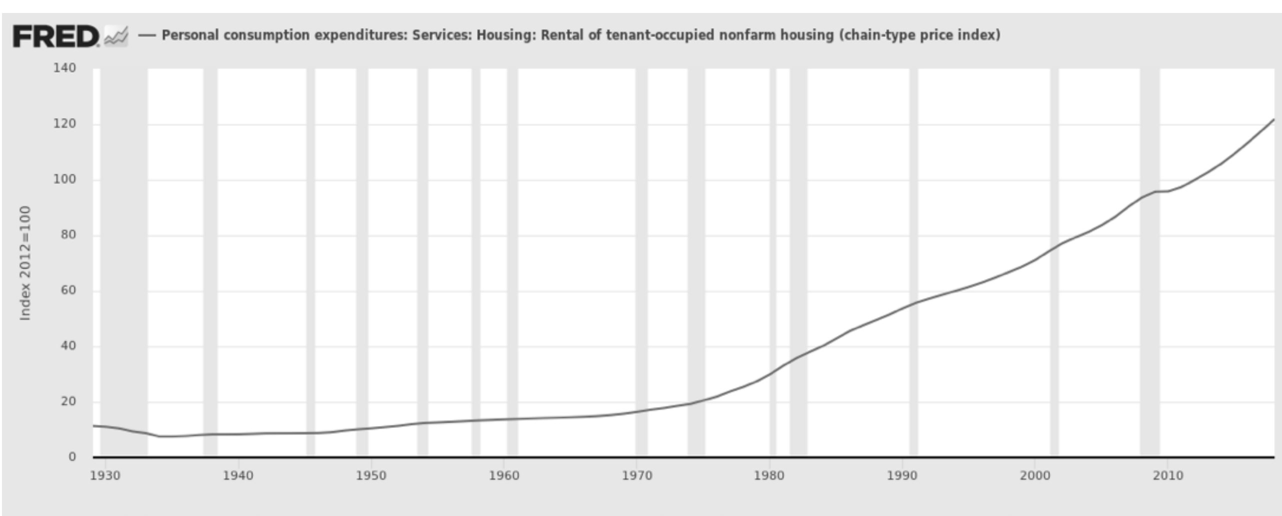
if you're going to be around for as long as CWS has been and make as many investments as we have, there is no avoiding having to take the "hard" path from time to time. Let's start with some of the easier components. To pull from the Buddha who emphasized in the Eightfold Path things like right speech, right effort, right action, etc. there are also some critical "rights" to lessen the probability of losing money for CWS.

Right Focus on the Right Business – As Lincoln said, "A house divided against itself cannot stand," it is hard to be good at multiple businesses. That's not to say it can't be done but typically firms with a relentless focus in a particular area tend to outcompete and outperform those that are more scattered. In addition, it's critical to be in a good business for as Warren Buffett says, "When a management with a reputation for brilliance tackles a business with a reputation for bad economics, it is the reputation of the business that remains intact."

A good business has compelling long-term demand fundamentals which enables its owners to have pricing power to absorb cost increases and to generate an acceptable return on capital deployed. Apartments have exhibited those characteristics and we have been able to do well investing in them because of their positive attributes.

To put this in perspective, the following chart shows the government's estimate of rental housing consumption over many decades. One can see that it has been in a continuous uptrend which is a business that has a high probability of longevity, particularly if it fills a



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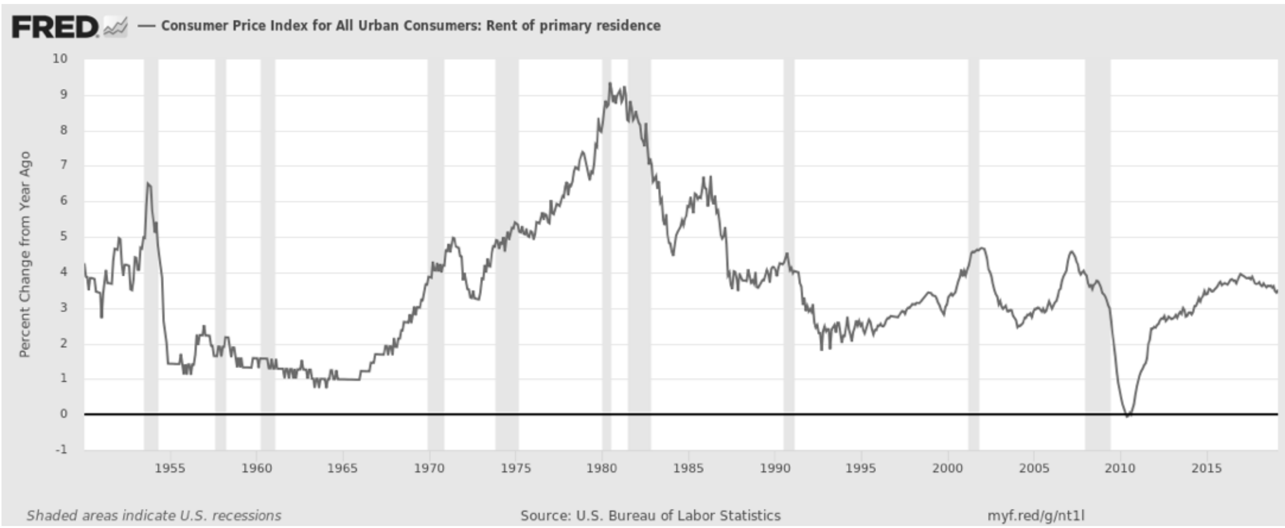
basic need, such as housing, that is not easily disrupted.

The next chart shows a proxy for rental housing rent growth. It is the component of the CPI index that tracks the rent equivalent of primary residences. One can see that this meets another important characteristic of a good business, which is pricing power.



Right Locations – To generate a compelling return over time one also has to be in the right locations. The markets that we are in have generated jobs at approximately four times the rest of the country since 2000. The same is true for population growth. We have done a good job of investing in growth-oriented locations where there are high-paying jobs. We have been focused on where knowledge workers want to be since the late 1990s and this has served us well.

Right Financing and Right Investors – We have come to learn how important it is to have the right financing in place to give us options to be able to refinance loans when rates or structures become more favorable or to be able to sell properties without being constrained by onerous prepayment penalties. The tradeoff has been that we have taken on interest rate risk compared to fixed-rate borrowers and this has led to volatility in our cash flows. With that being said, however, we have still generated significant interest savings and the relatively minor prepayment penalties that come with these loans have enabled us to make early repayments of over $1 billion of floating-rate loans via refinances and property sales. For example, in 2015 we refinanced 18 properties when interest rate

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spreads compressed and loan structures became more favorable with longer interest-only periods. In addition, at the end of 2018 we refinanced 12 loans to take advantage of another favorable window for borrowers. We could not have done this with fixed-rate loans as the prepayment penalties would have been too onerous. We had the added benefit of having our prepayment penalties waived because we refinanced with the same lender. This would not have been possible with fixed-rate loans, as they do not waive them even if refinancing with the same lender.

Once we have the right business, apartments, in the right locations and matched with optimal debt capital, it's then critical that we bring the right investors into the fold who share our long-term orientation and recognize that apartments are a get rich slowly type of business that requires patience and capital to weather inevitable downturns. With such partners we become more able to manage the cyclicality of the business and better align the returns we think we can generate with our investor expectations.

Right Team – With the right business in the right locations financed with the ideal debt and equity, we have found that controlling our own destiny has served us well by having a deep and capable team to execute our business plans, and a team comprised of people who embody CWS' values and are additive to our culture. Because the environment is always changing, we must also be able to generate compelling ideas so that we can continue to add value.

Putting that all together results in the "easy" way of being successful.

The "hard" way is when problems arise. And with over 100 properties in our portfolio and more than 70 properties we have sold since being in the apartment business, we will inevitably make mistakes—such that our premises may be wrong, our assumptions too optimistic, or we just can't hit our stride. Whatever it is, we will not get them all right. And this is where the rubber meets the road. Fortunately, apartments can be somewhat forgiving if you can hang in there during the tough times because they have winning long-term characteristics, particularly in the right locations. This requires strong values, a great team, a sterling reputation, and financial staying power.

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And that's why you need the right values to avoid temptation and a culture and organization that is one of shared sacrifice, cooperation, creativity, competitiveness, long-term orientation, community-focus, caring, and commitment to excellence and growing people. With that we can overlay tenacity and staying power and thus increase the odds substantially that we will make it through the difficult times and downturns. If you don't have the staying power then you are going to have a high probability of losing properties when you're leveraged, times get tough, and rents drop. Despite the revenue decline you still need to keep maintaining your properties and attracting residents to either stay or to move in.

Losing properties is quite detrimental to one's reputation with one's lenders and investors as well as hurts one's track record. All of these conspire to make it more difficult to attract growth capital, particularly during those dark times when values are most compelling. This is something that we experienced when we aggressively invested in the aftermath of the creation of the RTC and in the wake of the Great Recession. It's vitally important to have capital when it is in short supply while others are playing defense trying to clean up problems and asset values are depressed with a lot less competition to purchase them. Our goal is to minimize errors of optimism during the good times so that we can remain on offense during the difficult times.

So there you have it. 50 years summed up in a little over 1,500 words. It has been an extraordinary honor and privilege to have worked at such an outstanding company with people who are like family to me and will be lifelong friends. And to know that I have played my part in helping to enhance the lives of our investors, residents, and employees makes it even more gratifying.