Volume 29, No. 2, July 31, 2015

Quarterly Update
CWS Capital Partners LLC

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CWS

CALENDAR OF EVENTS

Monday, September 7, 2015
Labor Day
CWS Offices Closed

Tuesday, September 15, 2015
3rd Quarter 2015
Est. Tax Payments Due

Thursday, October 15, 2015
2014 Personal Income Tax Return
Extensions Due

Friday, October 30, 2015
3rd Quarter 2015
Quarterly Packages Mailed

November 2015
CWS Capital Partners
Semi-Annual Conference Call

Thursday, November 26, 2015
Thanksgiving Day
CWS Offices Closed

Friday, November 27, 2015
Day after Thanksgiving
CWS Offices Closed

Thursday, December 24, 2015
Christmas Eve
CWS Offices Closed

Friday, December 25, 2015
Christmas Day
CWS Offices Closed

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From Fare Thee Well to Keep on Truckin'!

By Gary Carmell

In a recent blog post, I wrote about my trip up to Santa Clara, CA to see one of the final "Fare Thee Well" shows for the Grateful Dead, commemorating their 50th anniversary. In that post I talked about my fascination and admiration for the Dead's very successful and innovative business model that in many ways was the precursor to the models being used by many successful technology companies today. Uber and Facebook are two notable examples. As a result of that blog post, I was asked to do some follow-up writing, even speaking, about this kind of business model, one known as open source. It occurred to me that as flattering as these requests were, I thought it might be initially more important that our investors understand the CWS business model. We strongly believe that our investors should not only understand to the best of their ability what they're investing in, but also with whom they are investing.

My first boss at CWS when I started in 1987 would constantly say to me, "Have fun and don't spend any money." Now that's a pretty simple business model and approach to life! Similarly, one initially might think that our job is to make the most money we can for our investors while taking prudent risks. Ahh, but there's the rub. This sounds very simple and a seemingly manageable objective, but history suggests that this is not the case as the road is littered with the carcasses of investment managers that failed to

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accomplish this and ended up losing money for their investors and no longer being in business.

After nearly 30 years in this business at a firm that has successfully navigated treacherous economic and financial cycles since 1969, one vitally important lesson I have learned is that one wins by not losing. Markets are made up of fallible human beings who are subjected to falling prey to fear and greed. Greed leads them to take imprudent risks, often times with borrowed money. When the tide goes out and greed turns to fear, waves of panic selling can ensue to repay nervous and impatient lenders and/or investors. This can lead to the proverbial blood on the streets. I like to quote General Patton and apply what he says about war to investing:

"The object of war is not to die for your country, but to make the other bastard to die for his."

That is how I feel about how one can achieve long-term investment success. Don't be the one that is forced to sell at the most inopportune time either by lacking emotional fortitude or being backed into a corner financially where one has no choice but to liquidate. When there are times of chaos and carnage it is vitally important to have the staying power to make sure that one does not get swept under the ocean permanently and drown. One must have the wherewithal to handle the pressure and either stay above water or resurface relatively unscathed by having access to capital to not only protect oneself when times get tough, but also to take advantage of the inevitable opportunities that arise when forced selling materializes.

Bill Gates has said that it's easy to be a visionary, but it's hard to be a CEO. To turn a vision into reality requires disciplined, thoughtful execution. CWS' major organizing principle from a company design standpoint is to minimize the chances of being all-in at the top with unsound capital structures, to have access to capital when it is needed to support investments when things go off course, and to take advantage of opportunities when they materialize. This is by no means an easy undertaking. It ultimately requires that we have long-term patience along with permanent capital. In order to access this capital, we need investors that share the same long-term orientation as we do. This is very important because it's been our experience that having pre-stated liquidation time frames for investments may look and sound good on paper, but often can occur at suboptimal times – either one is selling too early or one is forced to sell when times get tough. It's important that one invest with a seasoned, experienced general partner, as well as one that is financially sound because investors do not want the general partner/sponsor to have financial troubles when everyone else is as well. They too need to have staying power so they can make clearheaded decisions that are in the best interests of everyone involved.

It's interesting to draw some parallels between CWS and stock market investing strategies. There's a value orientation, which is to look for relatively deep discounts to what people think companies would trade for if taken private or with certain catalysts the value can be unlocked. There is a momentum style that chases good performance with the expectation that it gets even better despite the price appearing rather high. There are event-driven strategies, which are betting on takeovers, restructurings, or recapitalizations. There is a hedging approach where one can go long and short in a way that is somewhat market neutral with lower risk. There are also strategies that are very focused such as international investing or in specific sectors. The list goes on and on.

Since CWS is a direct owner and operator of real estate,

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we aggregate capital from our equity partners and our lenders to buy and develop properties. We control those businesses and those cash flows and the resulting capital allocation decisions. We at times have an activist investment strategy somewhat akin to Carl Icahn and Bill Ackman, although not as public and overtly aggressive. It's a strategy that evolves based on where we see the best risk-reward relationships. One thing most activists do is to try to agitate management and initiate big change. In some cases, we do as well. We go in and turn around properties by repositioning and upgrading them. And yet that is not always necessary for us to be able to add value. We can also utilize a value-oriented strategy by purchasing properties in markets that we think are overlooked by investors and that offer good upside potential as the economy improves such as when demand outstrips supply, rents are rising, and investor interest rekindles. This is not to say we don't manage these properties aggressively, but the business plan does not call for real aggressive action. It requires us to handle the blocking and tackling effectively, putting our CWS TLC into the properties, and then having the results materialize.

We are also not averse to using a momentum strategy as well which is something we're doing in Seattle. Property owners have experienced nice rent growth and a commensurate run up in values and yet we believe there is even more meat on the bone. Many of the people moving there are well-educated and in high demand by the growing tech companies and are able to earn impressive incomes with good growth potential. In addition, housing prices are relatively high which creates an affordability issue and yet there are some natural constraints to significantly overbuilding there. Given all of these factors, we actually look at Seattle, despite the appreciation that has occurred there, as offering compelling momentum that should push values higher.

Once we have decided on the best approach and time frame for creating value, we then overlay our financing strategy to optimize our cost of capital and to maximize the flexibility to prepay the debt so we are not locked into a specific time frame to either sell or refinance. Although we don't have a specific hedging strategy, we do end up having some of those benefits based on our geographic dispersion, urban properties, suburban properties, student-housing properties, repositonings, etc.

To make all of these investments come to fruition and to be successful requires a very deep, vertically-integrated organization – one that CWS pays for by having a reliable, recurring source of revenue through our management fees. These fees allow us to design and build an organization that can be patient and long-term oriented to enable us to make the necessary investments to compete at the highest level in what is becoming a more sophisticated technology-centric business. This allows us to have real-time pricing availability for residents that can change daily as well as customizing lease structures. These are things we couldn't do before but are necessities to compete effectively for our more connected and savvy customers. In addition, we have invested in much more sophisticated operational analytics and debt management software. Organizationally, we have deep and talented teams in the following areas:

- Human Resources
- Training
- Information Technology
- Risk Management
- Asset Management
- Property Management
- Capital Projects
- Acquisitions & Dispositions
- Transactions (Closings)
- Investor Relations
- Accounting

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- Development
- Due Diligence
- Compliance
- Marketing

All of these come together in a way that allows us to not only generate investment insights, but also enables us to go out and find the properties that we think can support our investment theses to take advantage of where we see the best opportunities. We are then able to do the due diligence and raise capital through our equity investors and our substantial debt relationships. We're able to close on the newly acquired properties, integrate them into our property management system, hire and train the necessary staff, operate the assets, provide reports, execute the business plan, and then in midstream either refinance and lower our cost of capital or return the money and/or sell the property when we think we have extracted the most value relative to the investment objectives.

This is a long-winded way of trying to shine a light on where the fees CWS generates are invested. We price them in a way that we believe is fair, while at the same time allows us to field the best teams and build one of the industry's finest and most effective organizations. The acquisition fees also allow us to keep a staff of very talented investment-oriented professionals and have great relationships with brokers and sellers while also having the intellectual horsepower and experience to generate excellent, actionable insights for us.

As I stated earlier that one often wins in investing by not losing, the same can be said for property management. It's really important if something goes awry at a property and a key player is underperforming or something happens to them that we have a deep bench from which we can backfill key personnel. This is one of the principal reasons we invest heavily in our training programs and leverage this with a critical mass of properties in the regions in which we operate. As a result, we can have a bench to turn to which can allow for people to take on new challenges, experience growth, and become important contributors. I know when we started investing in the Atlanta region, it was very helpful that we had enough motivated, mobile people in the company that were willing to move and help start a new region. The experience gained by them and us as a company has been invaluable. As we progress in Seattle, we will be doing the same thing. Hopefully we will be growing in Phoenix as well and continue to expand in Denver.

The ultimate takeaway from this great pontification is that CWS has a business model that is predicated on having long-term, patient capital that allows us to earn a recurring set of revenues that can provide the resources to invest in the infrastructure and talent to make us as competitive as any company in our industry. When times get tough, we have investors we can turn to that support their investments, if necessary, especially since apartments and real estate in general can be a pretty forgiving asset class. Owning properties in good locations and growing economies will oftentimes compensate investors sufficiently for supporting them when times get tough. As a result, we try to stick with high-quality communities and dynamic locations to better manage through the challenging times. And finally, if we can go on offense and access capital at a time when it is scarce, we can then make some real game changing investments that have the potential to produce very compelling returns with less risk than usual. This was where we found ourselves between 2011 and 2013. We still think many great opportunities exist to deploy capital in the apartment arena, but we now have to be more selective than earlier in the cycle.

So we really do have many ways to add value, but it

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really starts with our deep and trusting and long-term relationship with our investors. With that, recognizing that this is a long-term way to earn money, we can all prosper together. And to think this was inspired by seeing a Grateful Dead concert!