Volume 38, No. 4, January 31, 2025

Quarterly Update
CWS Capital Partners LLC

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CWS

CALENDAR OF EVENTS

March 14, 2025
Year 2024 K-1
Target Mail-by Date

April 15, 2025
2024 Federal/State Tax Filing Deadline
1st Quarter 2025 Est. Payments Due

April 25, 2025
1st Quarter 2025
Quarterly Reports & Distributions

May 26, 2025
Memorial Day Holiday
CWS Offices Closed

June 16, 2025
2nd Quarter 2025 Est. Tax Payments Due

July 4, 2025
Independence Day Holiday
CWS Offices Closed

July 25, 2025
2nd Quarter 2025
Quarterly Reports & Distributions

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APARTMENT RENTS – A COILED SPRING?

By Gary Carmell

In the Talking Heads song Psycho Killer, David Byrne sings, "Say something once, why say it again." I'm usually in that camp, particularly when someone is upset with me. You don't need to keep repeating the same thing over and over for me to get what you're trying to communicate. Obviously this is a defensive reaction on my part but I still generally feel that way.

When it comes to communicating the compelling reasons for making an investment, however, I'm actually in the opposite camp where I think it's better to overcommunicate and to repeat if necessary. The most obvious reason is that, unlike an argument between two people, it's rare that the same audience will hear or see all of the previous messages. Secondly, most people enjoy hearing a good narrative more than once because additional absorption of the information is not only satisfying but allows for a more nuanced, deeper understanding each time it's seen or heard.

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Given this I will use this opportunity to again point out why apartment rents in many of our markets offer a tremendous value and, dare I say, are too cheap relative to the cost of buying and owning a home and the rents needed to justify breaking ground on new apartment communities.

And while David Byrne laments saying things more than once, he doesn't communicate an opinion about showing charts multiple times. I will use this omission as poetic license to lay out a very nice buffet of charts that I think do a really good job of telling the story of an industry that is experiencing some fragility, but that by the end of 2026 there should be a materially different set of conditions for most markets.

We are increasingly in the camp that there's the potential for rents to be a coiled spring such that apartment owners may experience heightened pricing power and outsized gains in their operating income and cash flows. Of course, there are no guarantees and I have always tried to live my life probabilistically so I recognize that whenever I am investing my time or money based on a hypothesis that there is always a chance it may be wrong so I should always take this into consideration. On the other hand, if there is a reasonable chance that it may turn out to be correct and the upside is significantly greater than the downside, it's just such asymmetrical bets that can make a big difference in the financial outcomes of one's life if one has the courage to bet accordingly.

Prior to showing the potpourri of charts, let me summarize what we see unfolding.

There is a massive supply of new apartment units being completed leading to deeply discounted rents to fill up those newly constructed units. This has the following consequences:

- → Discounted rents are too low for most people to leave renting and purchase a home at near record high prices and very high interest rates.
- → These discounted rents and minimal competition from home ownership stimulate the formation of new renter households to absorb most of those new units.
- → Rents are too low to enable developers to get capital to break ground on new communities as the returns are too low relative to alternative investments, particularly buying existing communities at prices below replacement cost.

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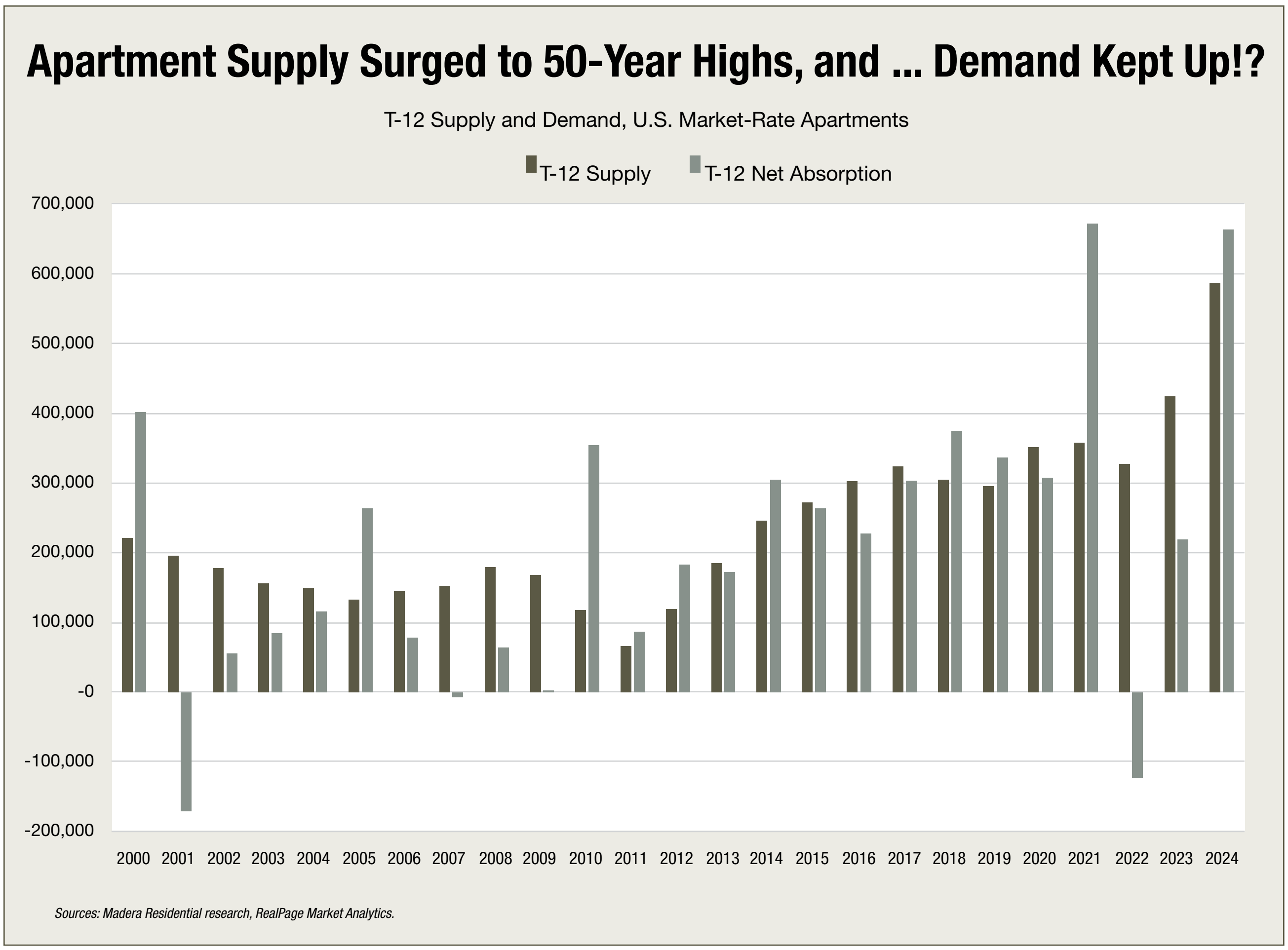
→ New supply is dropping significantly because of the unattractive returns from building.

Conclusion:

Once this wave of supply is absorbed, stabilized occupancy is reached, and apartment owners have far less competition from financially stressed developers, then they should be able raise rents far faster in order to start achieving rents that move closer to the much higher levels needed to start building again as well as making homeownership more attractive.

Let's turn to the charts to help support this hypothesis.

This chart shows how apartment supply has hit 50-year highs and yet, demand has actually kept up showing that supply can stimulate demand, particularly if the price is right.



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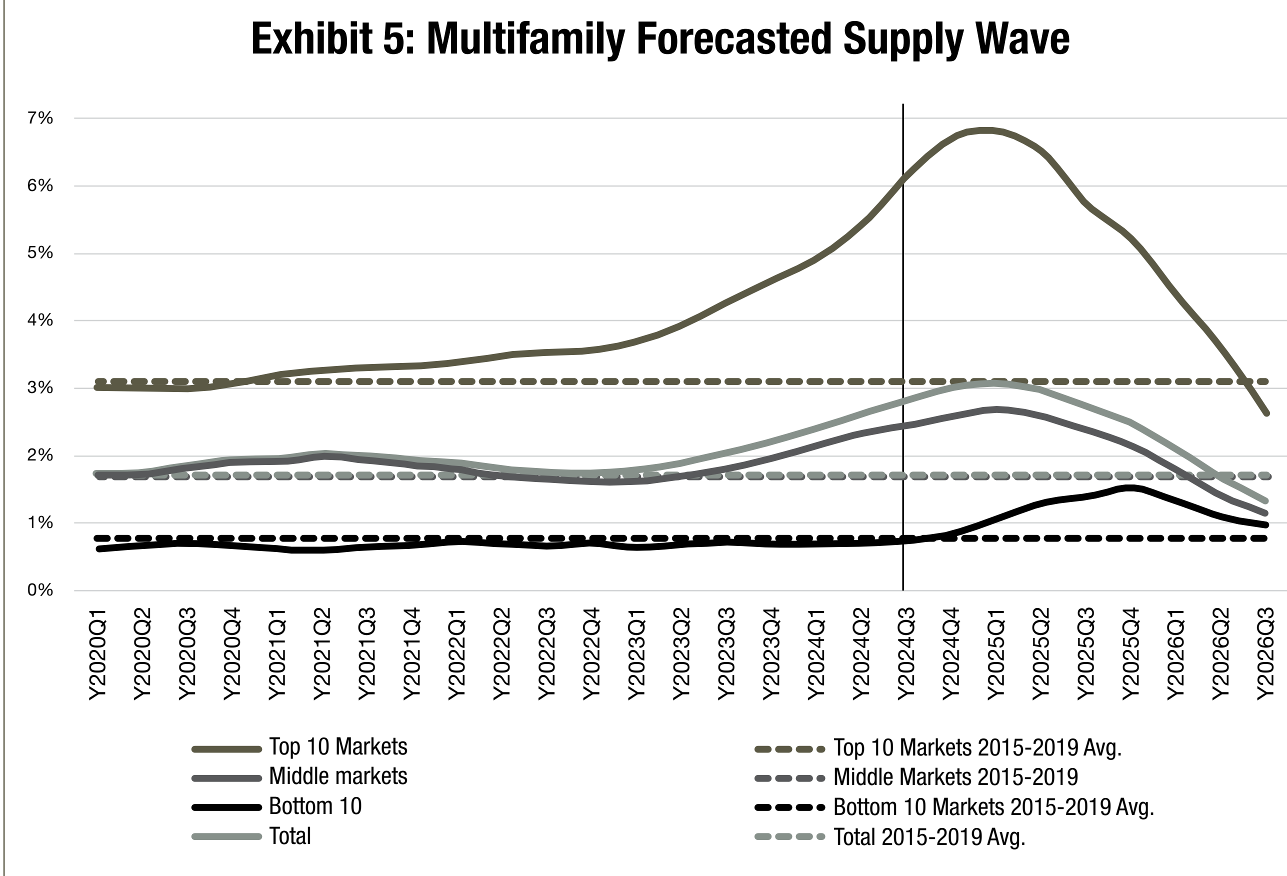
All real estate is local, however, so some markets are experiencing far more supply growth than others. This chart shows how the 10 most highly supplied markets compare to those not experiencing a similar supply boom. Unfortunately, of the top 10, four are CWS markets. These are Austin, Raleigh, Charlotte, and Nashville.



Note: Top/Bottom 10 Markets are by inventory ratio as of 3Q 2024.

One can see from the next table that rents have not increased very much since the beginning of 2023. Virtually all of the cumulative rent growth shown in the table occurred between 2020 and 2022. On the other hand, homeownership costs and incomes have continued to rise with the former quite significantly and the latter on a more steady basis. What is clear is that while wages have barely kept up with the increasing cost of homeownership, they have more than exceeded the increase in rents. This puts renting in a far more favorable position than homeownership as the table reveals.

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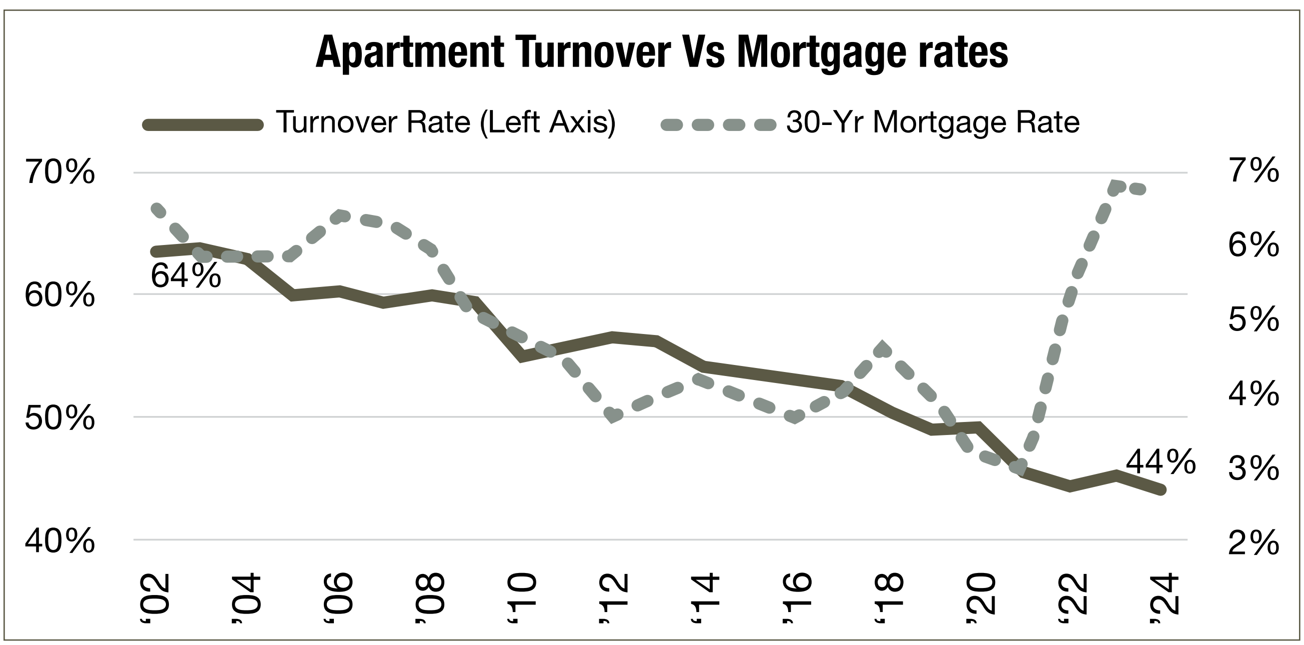
Exhibit 3: Monthly P&I Costs for the Median Sales Price of a Home Compared with Rent

Year/Quarter	For-Sale				Multifamily Monthly Rent	Multifamily YoY Rent Growth	YoY Wage Groth
	Mortgage Rate	Median Sales Price	Monthly P&I	YoY Change			
2020	3.1%	$298,485	$1,012	-17.6%	$1,426	0.0%	3.6%
2021	3.1%	$352,048	$1,199	18.6%	$1,535	6.9%	3.8%
2022	5.9%	$384,461	$1,821	51.8%	$1,749	11.7%	6.3%
1Q 2023	6.3%	$379,473	$1,883	18.7%	$1,786	4.5%	6.4%
2Q 2023	6.7%	$386,928	$1,999	10.2%	$1,811	2.4%	5.6%
3Q 2023	7.3%	$392,047	$2,152	8.7%	$1,825	0.4%	5.2%
4Q 2023	6.6%	$394,804	$2,019	6.0%	$1,807	0.2%	5.2%
1Q 2024	6.8%	$398,563	$2,077	10.3%	$1,808	0.2%	4.7%
2Q 2024	6.9%	$404,170	$2,121	6.1%	$1,828	0.2%	5.3%
3Q 2024	6.1%	$403,825	$1,954	-9.2%	$1,841	0.3%	4.7%
Change Since 1Q 2020	3.0%	$105,340	$942	85.7%	$415	20.2%	25.0%

Sources: Freddie Mac, National Association of Realtors, RealPage

This next chart is fascinating because even with mortgage rates having come down quite significantly between 2002 and 2022, the apartment turnover rate has come down as well. There has been a secular tailwind for apartment owners as renters have stayed in place for a longer period. And now with mortgage rates having spiked to close to 7% and home prices near record levels, the cost disadvantage is so pronounced that I'm hard pressed to see turnover rates going higher and, if anything, they should keep dropping. This serves to keep people renting longer and raises occupancy rates as there are less units available in the market to lease.



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Here is a headline from a recent GlobeSt.com article discussing how more people are staying for 10+ years as renters.

More Renters Stay for a Decade or Longer

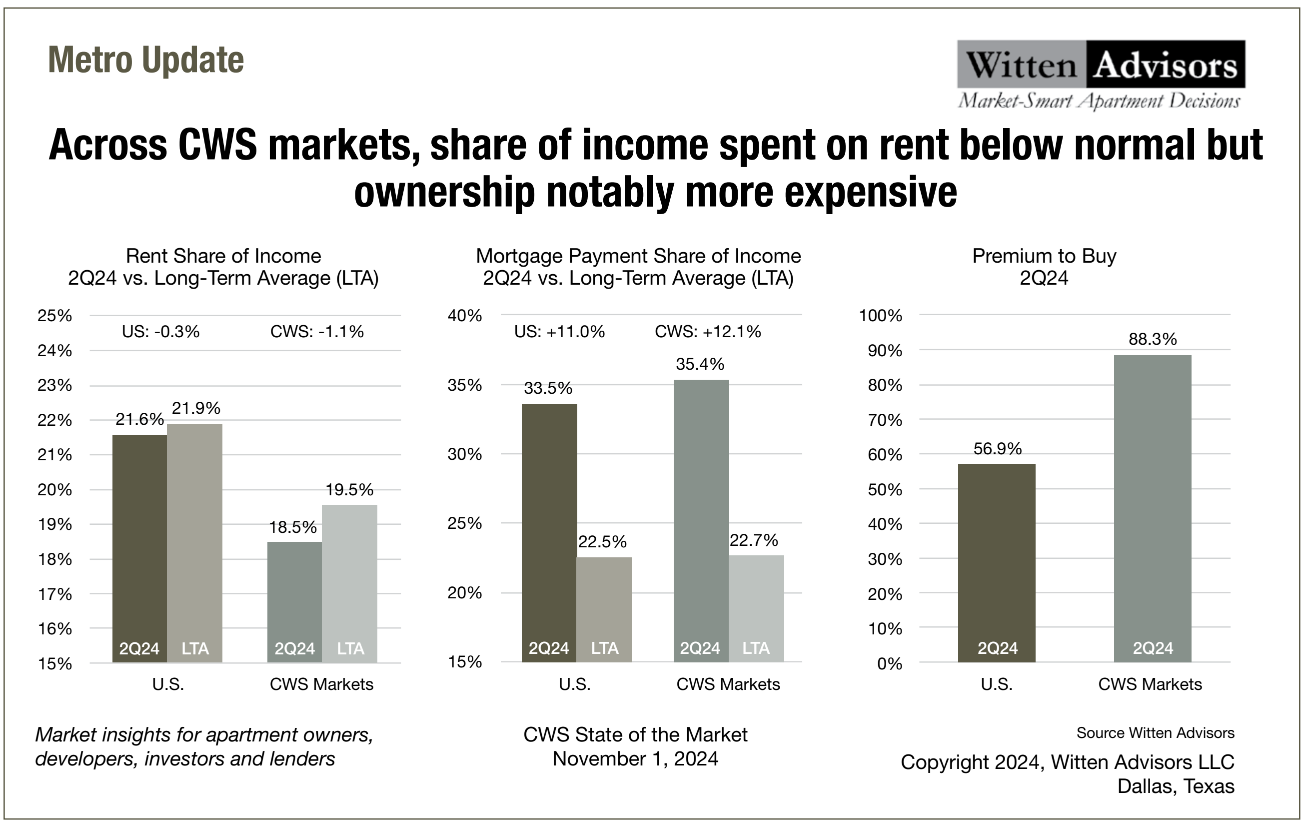
Denver, Austin, and Salt Lake city have the most short-term renters.

By **Philippa Maister** | January 02, 2025 at 06:29 AM

More renters are staying in their homes longer than did a decade ago, especially if they are baby boomers. Some 33.6% of U.S. renters have lived in the same home for at least five years, according to a new report from Redfin using 2023 data.

That statistic included the 17% of renters who had lived in the same property for five to nine years, compared to 14.4% in 2013, as well as the 16.6% who stayed put for 10 years or more, up from 13.9% a decade earlier.

Another factor in apartment owners' favor for future pricing power is that renters, particularly in higher quality, more expensive communities in CWS' markets, are paying a smaller percentage of their income towards rent as compared to their long-term average as this chart from Witten Advisors shows. And when compared to purchasing a home, the premium to buy for CWS' markets is not only extremely high on an absolute basis, but it's also much higher than the overall U.S. average. This should bode well for longer tenures for our renters.



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The next two tables are based on an analysis we did comparing an Austin garden development to acquiring an existing garden community between 2020 and 2024. Our experience in building in Austin is that development costs have risen by approximately 30% since 2020 while the purchase price of an existing garden community is down approximately 32%. The result of this is with higher interest rates investors correspondingly require higher yields when purchasing apartments and even higher ones for building given the risk and time frame to bring a project out of the ground to completion.

	Development Underwriting		
	2020	2024	Variance
Total Units	300	300	
Average SF	875	875	
Monthly Rent	**$ 1,400**	**$ 1,986**	**41.9%**
Rent PSF	1.60	**2.27**	
Total Cost	**55,500,000**	**72,000,000**	**29.7%**
Cost Per Unit	185,000	**240,000**	
Cost Per SF	211	274	
Unlevered Yield on Cost	**5.00%**	**6.50%**	**30.0%**

	Acquisition Underwriting		
	2020 (Spring)	2024	Variance
Total Units	300	300	
Average SF	875	875	
Monthly Rent	$ 1,619	$ 1,619	
Rent PSF	1.85	**1.85**	**-18.5%**
Total Cost	**94,500,000**	**64,500,000**	**-31.7%**
Cost Per Unit	315,000	**215,000**	**-10.4%**
Cost Per SF	360	246	
Cap Rate	**3.70%**	**5.00%**	**35.1%**

It now requires rents of approximately $2,000 to justify building a new apartment community in Austin while rents are only in the $1,600 range. And while it costs an estimated $240,000 per unit to build, we estimate that to purchase a high-quality garden community is $215,000. With the ability to purchase below replacement cost

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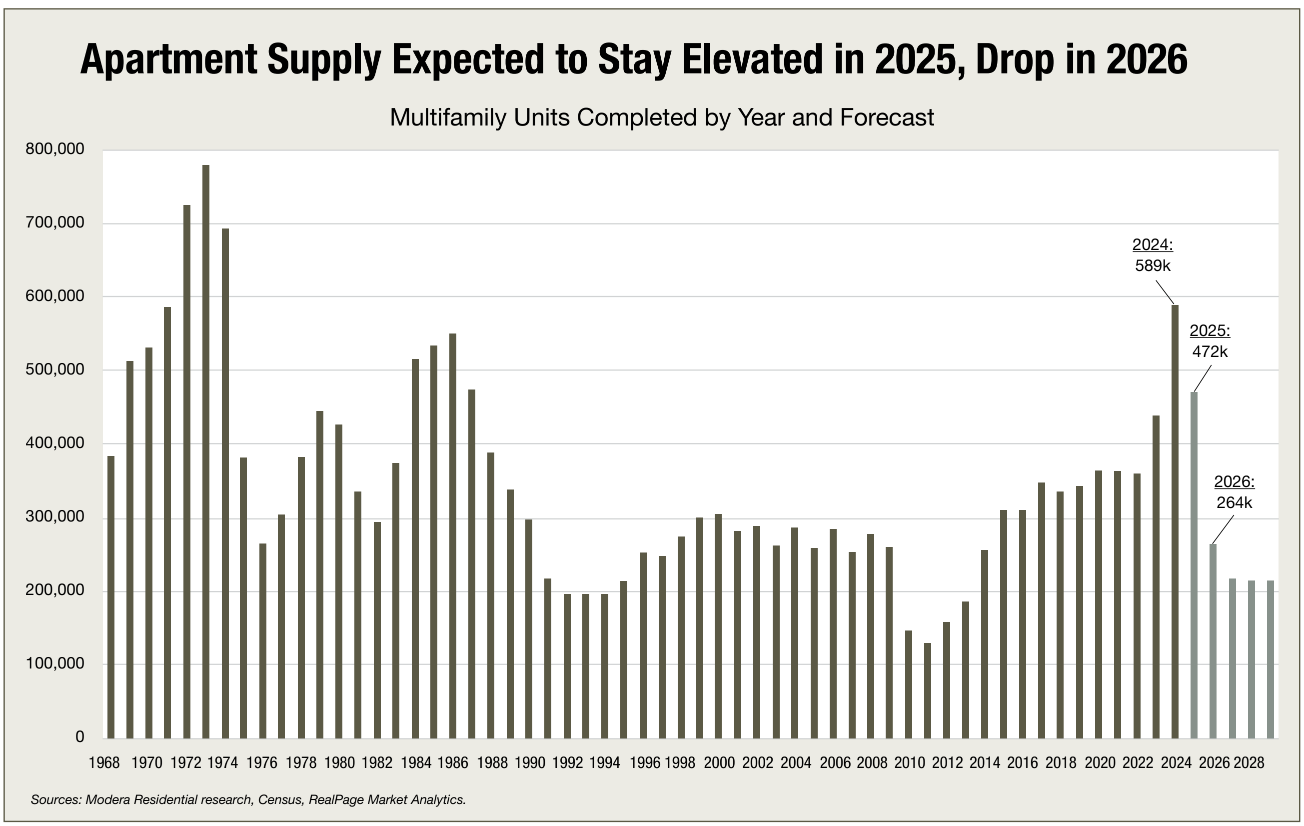
and an approximately $400 gap between existing rents and replacement cost rents this leads us to believe that once this large wave of supply is absorbed that rents are set for a meaningful acceleration.

Add to this that the median home price in Austin is approximately $573,000. Assuming an interest rate of 6.50% and a 90% loan with a 30-year amortization and property taxes of 2.5% of value and $200 per month of insurance, this equals a monthly payment of $4,653, which is more than $3,000 higher than the rent and a high-quality garden property in Austin without factoring in maintenance costs. Now that is something I shouldn't write or say once. It should be communicated over and over!

The coiled spring hypothesis is predicated on rents being too low relative to replacement cost rents and the cost of purchasing and owning a home, which I think is fairly well substantiated by what has been presented already. Now what we need is a major reduction in new supply to show that there is light at the end of the tunnel since demand is at unprecedented levels and is absorbing the units that have been coming online. And this is definitely the case as this chart shows how future apartment completions are expected to drop quite significantly after 2025.



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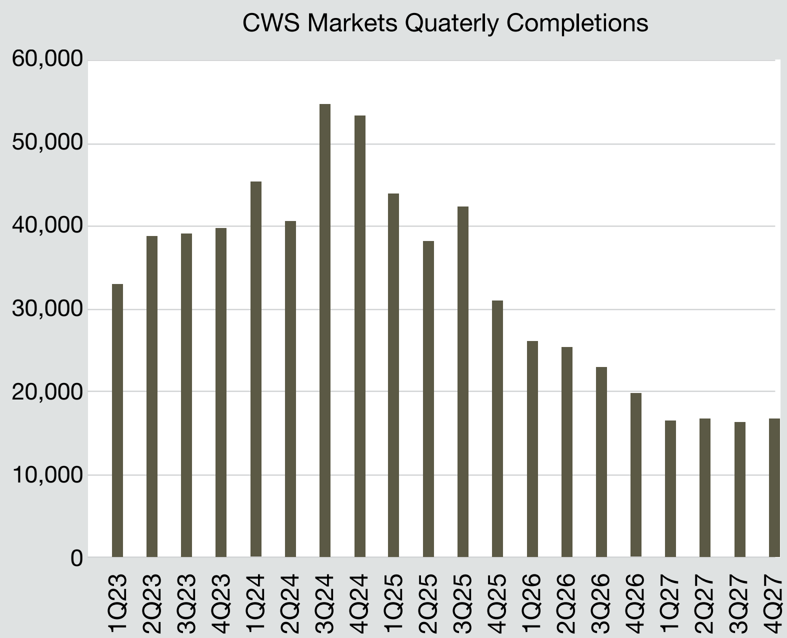
Looking on a more granular basis at CWS markets, this chart and table show the same trend and a projection as to when each market will experience peak completion. The only two markets that have not reached this milestone are Phoenix and Charlotte, which should occur during the second quarter of this year.

Metro Update

Witten Advisors
Market-Smart Apartment Decisions

Peak quarterly completion in 2H24 for CWS Markets near 55k units notable drop off after 3Q25; timing varies across markets



Market	Peak Completions
Atlanta	4Q24
Austin	3Q24
Charlotte	2Q25
Dallas	4Q24
Denver	3Q24
Fort Worth	3Q24
Houston	4Q24
Nashville	3Q24
Phoenix	2Q25
Raleigh	4Q24
San Antonio	4Q24
Seattle	4Q24

Market insights for apartment owners, developers, investors and lenders

CWS State of the Market
November 1, 2024

Source Witten Advisors

We think the story unfolding about the prospect of rents being a coiled spring becoming increasingly positioned to snap back with great force is quite compelling and should be told over and over. I say this because we are starting to get back on offense as we see opportunities to finally be able to deploy capital after having been largely dormant for nearly two years. We intend to be patient and discerning, particularly as long-term interest rates have gone up quite significantly since the Fed started cutting short-term rates in November 2024 as the following chart shows.

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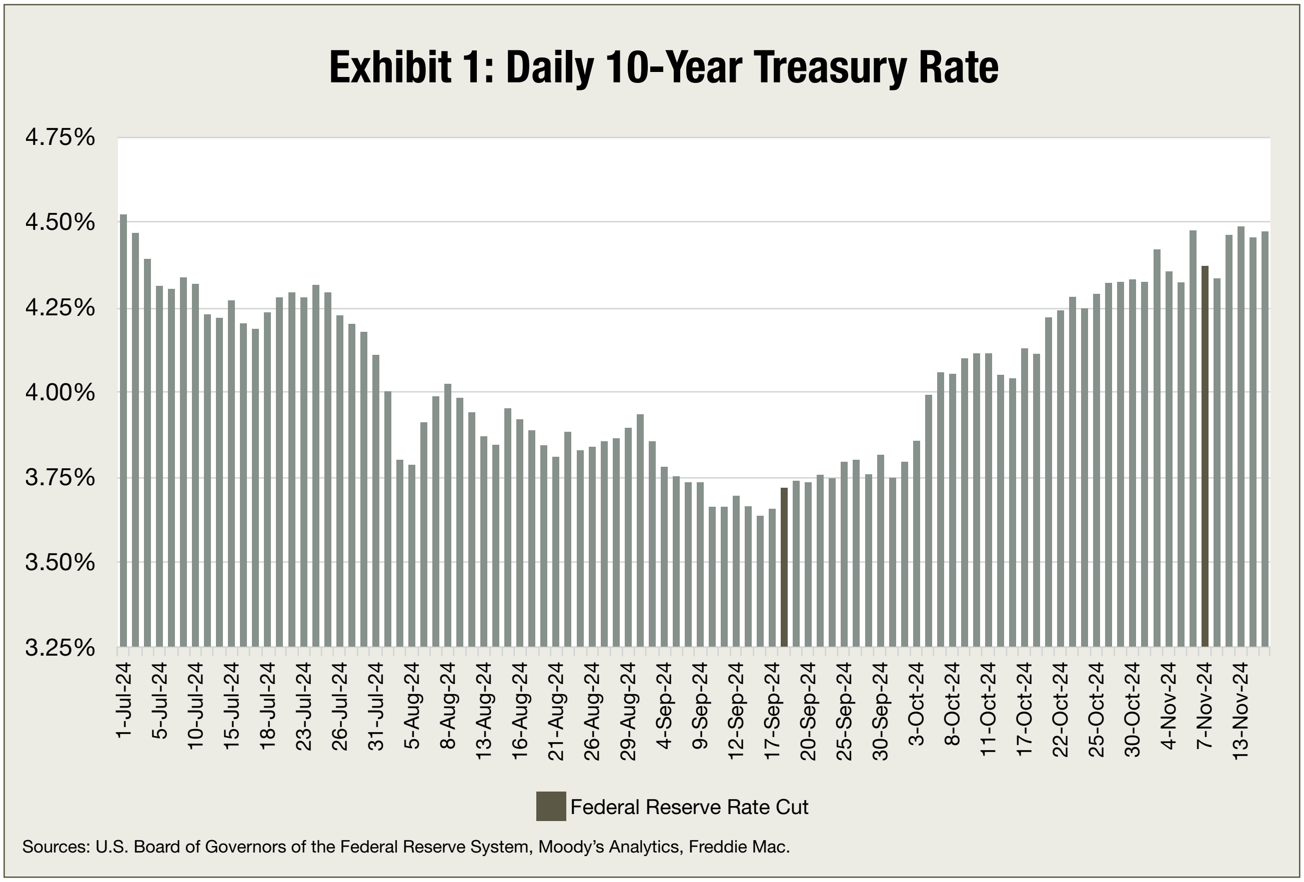

This could present some interesting opportunities for those borrowers challenged to refinance maturing loans in this higher rate environment. It has also pushed mortgage rates higher, which increases the cost of owning a home absent an offsetting price reduction. This will make the gap between renting and owning even larger if rates continue to rise.

With values having dropped quite materially from their record 2022 highs and now starting to go higher, combined with extraordinary demand from new households being formed and peak completions either having already happened or very close to taking place, the conditions are forming to having apartment investments become quite compelling again. We're intently watching that spring coil more and more with the expectations that sometime in the second half of 2026 or early 2027 it may uncoil quite forcefully.