

2017 CWS Annual Report

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Intellect

Our theme this year is *Excellence by Design*. CWS has always been a very thoughtful, intentional, and planning-centric firm. This probably has to do with the three founders being engineers. We have had annual planning sessions ever since the company was founded in 1969. The purpose has been to take a step back and do our best to assess our operating environment as objectively as possible and to determine our core competencies and resource needs to set objectives to take advantage of opportunities and to avoid taking poorly compensated risks.

We have made a concerted effort to design the company with a clear head so that we can be playing offense when many others are on defense and to avoid errors of optimism by having guardrails in place to keep us from going all-in at the top. As we have said continuously, if you buy well-located real estate in growing areas then staying power is key. Cycles are inevitable and the key is to have the financial resources to manage through the down parts of the cycle because it almost always pays off as these types of properties tend to fully-recover and continue to grow in value. This has led us to design the firm with a long-term orientation which requires that we have patient, long-term investors who understand that the apartment business is a get rich slowly type of business but offers compelling opportunities for current yield and compounded growth over long periods of time.

When we marry our thoughtful, long-term orientation with a stable and talented team of committed employees who are focused on excellence in all that they do, then we have the winning formula for producing Excellence by Design.

We believe that we must strive for excellence to help bring about the financial outcomes we are targeting. These outcomes are a byproduct of many things we have to do well. It is imperative that we make sure that the totality of the customer experience is highly satisfactory in terms of our service level and engagement, our information delivery and response are timely, accurate, and relevant, that all of our interactions are respectful, and we uphold our high quality standards all the while being mindful when it comes to our spending. The goal is to attract and retain the best customers and employees consistent with our values and long-term orientation to enable us to earn competitive rates of return for our investors. The areas that we believe we must excel at are as follows and the letters that follow will cover each of these.

Culture (Steve Sherwood)
Intellect (Gary Carmell)
Execution (Mike Engels)
Relationships & Communication (Bill Williams)

One time my wife and I were being pitched a timeshare and we were asking a lot of financial/analytical type questions to the salesperson. The salesperson was clearly irked and said to us “You must be thinkers. This is not the type of investment for thinkers.” Needless to say we passed on it.

At CWS we are thinkers too so it is important that we systemize ways to tap into our intellect to improve the odds of generating compelling ideas for which we have the resources and capabilities to execute and be able to add value by delivering competitive risk-adjusted returns to our investors. This requires that we ask the right questions, find the information to help us answer those questions, tap into various points of view, and do all we can to stay objective, especially when we don’t like the conclusions we are drawing. As we have said before, we want to position ourselves to “eat when we’re hungry and sleep when we’re tired.” We want to do what is smart when it is smart to do and not be pressured to do so because of financial needs or envy.

Sticking to this Zen-like thinking, we have come to learn that it is important to squelch our comparative mind and cultivate a learning mind. The former is judgment-based and serves to bring us down versus the latter which is always striving to elevate towards our higher selves. It’s only interesting what others are doing if we can learn from them, but it can be highly destructive if it engenders envy and changes our behavior for fear of missing out. Our lower self manifests itself by being very reactionary, lacking impulse control, having the need for immediate gratification, being very short-term oriented, and focusing on others versus what we can control. Our lower self is rooted in ego, fear, and insecurity.

Our higher self, on the other hand, is intentional, ethical, customer-centric, thoughtful, design-oriented, long-term in nature, accepts delayed gratification as necessary and even welcomed to build a successful, sustainable business, and independent in one’s thinking but very open to learning from others. In addition, it is very open to saying no when it does not fit into one’s core competencies, it is ethically out of bounds, it’s a distraction, or offers a poor risk-reward relationship. In short, we are secure in who we are, what we believe, and what we are trying to achieve.

Our focus on rigorous, long-term thinking regarding key trends that we believe will impact apartment demand (and supply) as well as valuation and interest rates have enabled us to compound capital at over 14% per year during our nearly 30 years we have been investing in apartments. We have used our intellect to identify locations that we thought would attract knowledge workers since we believed that they would see their incomes grow much more rapidly than inflation. It also led us to invest in student housing, develop new communities, reposition assets when we thought that made sense, and to have a significant reliance on variable-rate loans because we felt that interest rates would stay low for a very long period of time and because we found the pre-payment flexibility highly valuable. This has paid off as we have saved over \$70 million in interest since 2011 and been able to pre-pay over \$800 million in loans through either refinancing them or selling the properties, which allowed us to capture a great deal of value because we could lower our interest rates and/or extend interest-only periods and not have to sell our properties at a discount because of the debt we would require buyers to assume.

Given these results and long-term track record, we will keep being thinkers and rely on our intellect for our decision-making and continue to design CWS for the long-term.