



2021 Annual Report Letter

Precursors: Markets

By Steve Sherwood

Founding Partner and Chairman of the Board

Years ago we looked at potential markets where we wanted to do business and used a set of criteria we felt would be important in predicting which markets would perform the best over the long term. These criteria include major cities with a pro-business attitude, attraction for knowledge-based workers and institutional investors, opportunity for a good quality of life, and proximity to major universities.

As we experienced a perfect storm like no other during the pandemic, it is interesting to see how our market selections held up in such an unforeseen set of events. During difficult times, being in the wrong location can increase exposure to threats on capital preservation and the performance of our portfolio, while being in a more favorable market can help avoid some of that risk. Fortunately, the markets we selected and where we do business are in the favorable group.

In addition to performing well over the past 30 years, our markets proved quite resilient during COVID and produced some top performers. CWS's monthly rent collection during COVID has varied less than three percentage points from pre-COVID collections. In contrast, the collections in California have been running as low as 70-80% of the monthly billings.

There is a dramatic change taking place in American willingness to relocate. In both California and New York, a net external migration of over 200,000 people from each of those states occurred in 2020. I would expect these numbers to increase in 2022. The markets where we operate have been the recipients of much of the net gain from people relocating. An interesting set of statistics measures the growth of high-paying positions by city. Six of the top 10 are represented by our markets – #1 Austin, #3 Raleigh, #4 Dallas, #5 Phoenix, #9 Charlotte, #10 Denver. Another set of valuable data measures the year-over-year rent growth in 43 major metros. In Q3 2021, CWS had three in the top 10 – #1 Phoenix, #5 Austin, #8 Atlanta, and none in the bottom ten.

There are dramatic social transformations occurring that could significantly affect which markets will be the best performing going forward. The work-from-home tech jobs can now occur in places like Boise, Reno, or Salt Lake City versus San Francisco. Those who will be working in the office two to three days per week can consider locations further outside of the city as commute times are less important. As cities make major

political decisions about controlling crime, homelessness, taxes, and being pro-business or anti-business, their desirability and prospects for future growth are at stake. The markets that will flourish going forward can likely be identified using our original criteria with some additional tweaks to account for the post-COVID long-term shifts. As such, we will continue to monitor the current and future performance of our markets as well as new markets we are considering.

Currently, our plan is to exit Seattle over the next couple of years based on the political uncertainty and anti-business sentiment in the City of Seattle. The political uncertainty risk outweighs the top of class, high-tech employers in Microsoft and Amazon. Tacoma on the other hand is stable and thriving.

At CWS, we rely heavily on our real-time, on-the-ground market data. In cities where we have a presence and professionals on the ground, our data systems and people give us insights into market dynamics ahead of our competition. When we consider new markets, this advantage does not exist. We are slow to add new markets, but when we do, our intention is to own at least five properties to provide us those unique insights. Nashville is currently under study to determine if it is a market we should add now or in the future. Our ongoing market study is something we will continue at a strategic level to produce good returns while preserving capital for our investors.