Discipline

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What a difference a year makes.

Last year at this time, this letter almost wrote itself. Whopping rental increases on top of super low interest rates were a perfect recipe for growing distributions and expanding apartment values. It felt too good to last—and it didn't. Rising rents and values were indicative of a broader inflation contagion, which led to sizable interest rate increases. These rate increases are resulting in meaningfully higher interest payments throughout our portfolio largely financed with variable-rate loans, which in turn have forced us to make significant reductions or suspensions in distributions for many assets in our portfolio.

The numbers are laid out in the chart below, showing the operating performance of 84 "same store" assets that we have owned continuously over the last three years, plus our performance objectives for this year.

One expense line item that is particularly noteworthy, we are forecasting that our insurance expenses will increase 60% this year. The gamechanger has been insurers realizing they have been insuring based on replacement values that have been far too low, and this year was a reckoning. Our replacement values were increased by approximately 25% on top of even heftier rate increases, which resulted in the overall 60% increase.

In short, despite a forecast of solid rent and Net Operating Income gains, we project that higher interest expenses will reduce our operating cash flows this year to $33.5 MM, down from $119.3 MM in 2021. These projections led to the significant distribution reductions or suspensions commencing this past January.

SAME STORE ROLL UP (in $ millions)

Properties: 84
Unit Count: 24,276

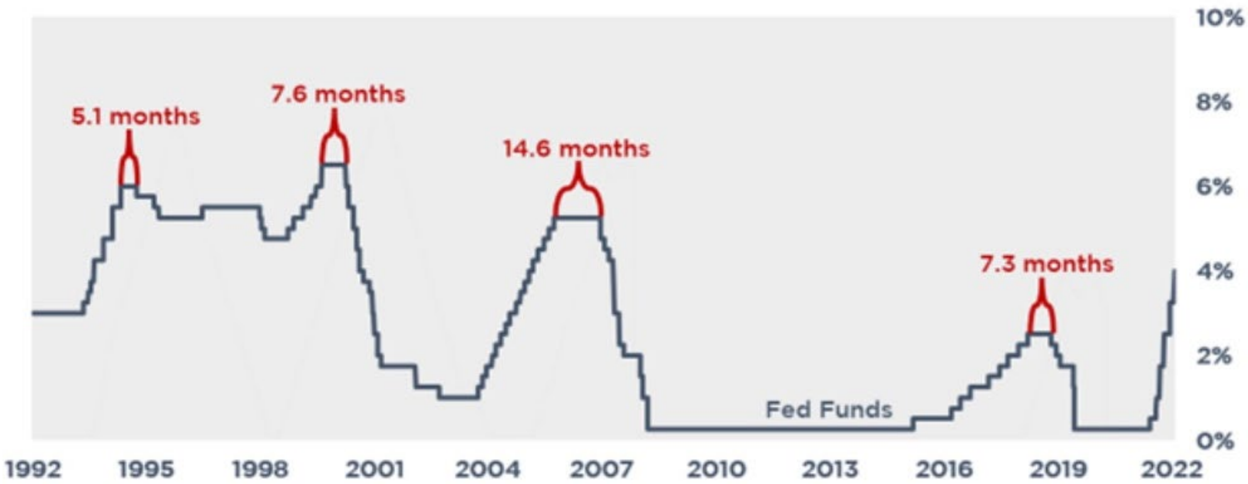
(in $ Millions)	2020	2021	20 vs 21 % Change	2022	21 vs 22 % Change	23 Objective	22 vs 23 % Change
Market Rent	426.7	491.9	15.3%	553.8	12.6%	572.6	3.4%
Vacancy	(25.5)	(26.7)	4.7%	(32.7)	22.6%	(32.0)	-2.2%
Concessions	(3.3)	(1.2)	-63.3%	(0.9)	-22.6%	(0.9)	-5.3%
Gain/Loss to Lease	(25.5)	(80.6)	216.4%	(91.6)	13.7%	(71.8)	-21.6%
Model/Employee Units	(1.8)	(2.1)	13.2%	(2.2)	3.9%	(2.5)	15.5%
Bad Debt	(2.3)	(2.3)	-2.4%	(1.7)	-27.3%	(1.6)	-6.1%
Net Rental Income	368.3	379.1	2.9%	424.8	12.1%	463.9	9.2%

Other Income	39.1	47.9	22.5%	46.6	-2.7%	46.3	-0.5%
Total Revenues	407.3	426.9	4.8%	471.3	10.4%	510.2	8.2%
Salaries	36.8	38.8	-5.2%	39.6	-2.2%	44.4	-12.1%
Marketing / Advertising	5.5	5.3	3.9%	4.8	10.1%	5.2	-8.3%
Turnover	6.0	6.2	-4.7%	6.8	-9.8%	6.9	-0.4%
Repair and Maintenance	5.0	5.4	-7.2%	6.0	-12.2%	6.2	-2.6%
Professional Services	9.8	10.4	-6.9%	10.7	-2.3%	11.7	-9.1%
General and Administrative	5.6	5.6	-0.9%	7.9	-40.3%	9.1	-14.9%
Utilities	25.6	26.4	-3.1%	27.3	-3.6%	27.4	-0.2%
Taxes	73.6	74.7	-1.4%	81.6	-9.3%	87.8	-7.6%
Insurance	7.2	7.8	-8.1%	9.6	-23.4%	15.4	-60.0%
Management Fees	13.2	13.8	-4.6%	15.2	-10.0%	16.5	-8.4%
Retail Expenses	1.5	1.4	7.2%	1.5	-8.9%	1.7	-15.2%
Total Expenses	189.8	195.7	-3.2%	211.1	-7.8%	232.1	-9.9%
Net Operating Income	217.6	231.2	6.3%	260.3	12.6%	278.2	6.9%
Interest Payments	68.4	55.8	18.5%	93.3	-67.2%	178.2	-91.1%
Principal Payments	9.1	7.1	21.5%	4.8	32.1%	4.8	0.0%
Other Expenses	13.0	10.8	16.6%	10.9	-0.9%	11.7	-7.6%
Capital Expenditures	32.4	38.1	-17.6%	53.7	-40.9%	47.7	11.3%
Reserves for Rate Caps less Reimbursements	1.4	1.7	-22.8%	1.4	20.2%	2.2	-63.1%
Operating Cash Flow	94.6	119.3	26.1%	96.1	-19.4%	33.5	-65.2%

That's the bad news.

While there is no sugar-coating distribution reductions or suspensions, there is a clear-eyed view of how our apartment portfolio is positioned today.

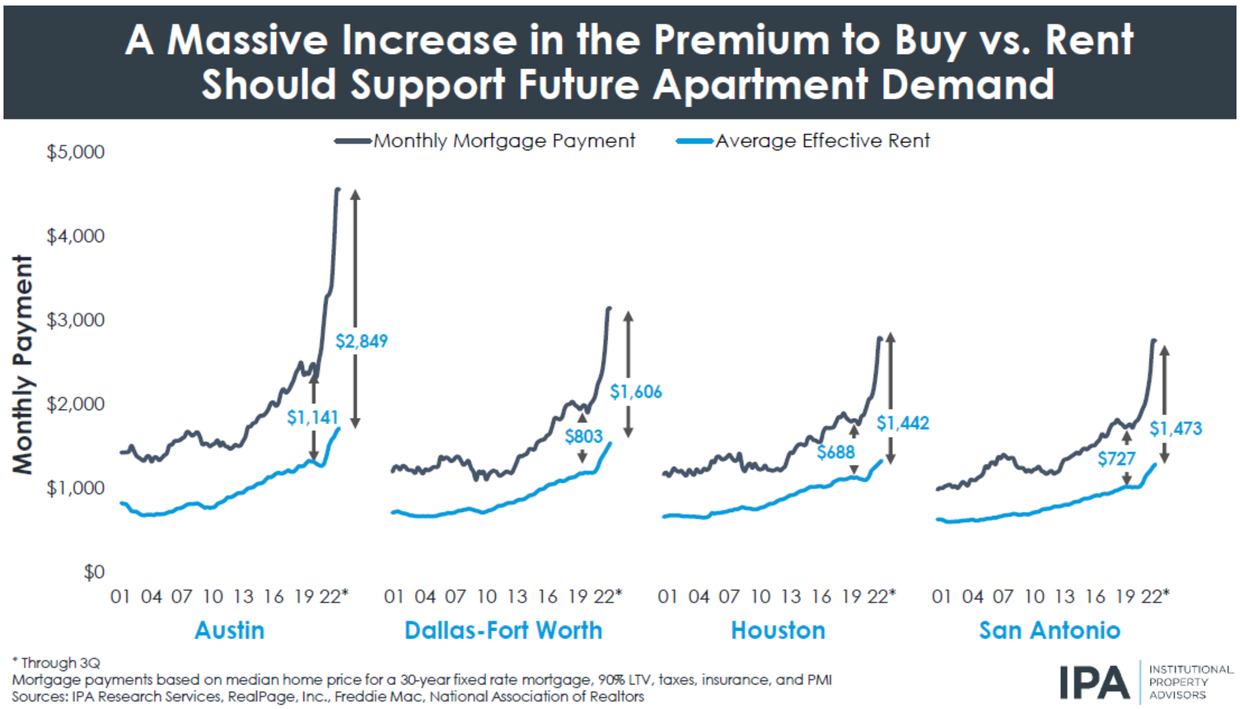
First and foremost, most every indication points to the Fed being near the end of its interest tightening cycle. Once an interest tightening cycle ends, after some period of time the next most likely step will be to reduce rates. Once the Fed pauses, it has averaged nine months to commence cutting rates based on the previous four cycles over the last 30 years. Our portfolio is well positioned to benefit from such a reduction.



Secondly, while the spike in rates has been harmful to distributions, at this time only two assets among our total 102-asset portfolio, Marq 211 in Seattle and Marquis at Buckhead in Atlanta, will need additional capital to support them through this interest rate spike (although this could change based on interest rates going higher than projected or the cost of reserving for the future purchase of interest rate caps becomes more expensive than projected). This benign outcome is a result of our disciplined practices of conservative leverage levels, healthy property working capital balances, and a multi-year campaign of reinvesting heavily back into our assets. The result of those actions provides us with a healthy portfolio that can compete effectively in what is expected to be a more challenging environment. Our variable-rate loans had significantly lower interest expenses than the fixed-rate alternatives for many years, resulting in higher cash flows from which we were able to reinvest in our assets and fatten our property working capital balances, as well as deliver distributions. Our variable strategy also provided the flexibility to opportunistically sell and refinance assets when it has been advantageous to do so.

Thirdly, the values of the bulk of our assets to date have held up well relative to our PAIR (Personal Annual Investor Report) values from last year, largely due to revenue and corresponding Net Operating Income increases offsetting higher capitalization rates (lower Net Operating Income multiples). That said, we did mark up a few assets relative to last year's PAIR values where we felt that higher Net Operating Incomes more than offset higher cap rates. Conversely, we marked down a few assets where higher cap rates more than offset higher Net Operating Income increases. Overall, we marked down our portfolio asset values less than 1.0% relative to last year (individual asset results of course will vary). While property values are down from their peak this past spring, last year's PAIR values were calculated prior to the peak which contributed to the very modest decline in this year's PAIR values versus last year's.

Fourth, the spike in interest rates has significantly slowed single family housing starts and multifamily permits, which over several years' time will eventually result in less competing supply, paving the way for higher long-term rent growth. Furthermore, sharply higher mortgage rates over the last year have more than doubled the premium to buy versus rent in many of our markets, which will support ongoing apartment demand.



Fifth, the current interest rate disruption may present interesting long-term acquisitions for our investors, At the time of this writing, it appears some compelling investment opportunities are materializing, which we will communicate to our investors at the appropriate time.

Lastly, as we reflect on this past year, CWS took advantage of some of the strong market in the earlier part of the year to put under contract and eventually sell seven assets. The seven sales averaged a 21.2% IRR and a 3.04x multiple for our investors, providing over $212.0 MM in investor profit (for a complete list of all realized investment recommendations made by CWS see the track record in the back cover of this annual report).

In summary, with cash flows tighter in the current environment, we will be hyper-focused on our operating portfolio, making disciplined and prudent decisions on expense control and continuing to raise rents where and when the markets allow us to do so. At the same time, we will be patiently seeking to capitalize on opportunities that appear for the long-term benefit of our investors. The tight integration between operations, asset management, and investments positions us well to collaborate in ways that will benefit us in determining which opportunities meet our stringent investment criteria.