REFLECTION

By Bill Williams
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One thing that I've learned in my five decades of being a Founding Partner, an Advisory Board Member, and a long-time investor with CWS is that every key decision we make can only be based on our best analysis using the best information available at the time.

The risk was always there that we could have a big spike in interest rates if the Federal Reserve set its sights on fighting inflation. Unfortunately, we didn't place a very high probability for this risk since historically for the past 40 years we had observed rates going lower, with each cycle peak rate falling lower than the previous peak.

This all changed when the government flooded the public with money during Covid and the Fed said that it would keep rates near 0% through 2023 at the earliest. We took the Fed at its word, and we were wrong. In 2020, we purchased a profitable interest rate cap for much of CWS' portfolio that returned about 11 times the cost but unfortunately it expired in December 2022. One of the lessons we learned from this is being more open to buying longer-term rate caps, especially when they are very cheap, and not looking at that cost as wasted insurance.

We could have placed more of our loans into fixed rates, but we valued the prepayment flexibility that our variable-rate loans provided us. This turned out to be an incorrect bias because had we locked in more of our loans into fixed rates, those rates would have been low enough to essentially eliminate those prepayment penalties since current rates have gone so much higher that lenders would have wanted to get their money back sooner to reinvest those dollars into a higher rate environment.

We viewed our portfolio of properties with variable-rate loans as one that didn't require much active risk management when it came to its debt. We preferred the flexibility it provided and prospered so much from it. Over the last 10 years we have prepaid almost $3 billion of our variable-rate debt which allowed us to sell our properties without large prepayment penalties or requiring buyers to assume our debt. It also allowed us to refinance into longer-term loans with better interest rate spreads and more interest-only payments, and at times allowed us to make substantial distributions to our investors. And with our interest rate caps we felt like we had pretty good disaster insurance. It was fun while it lasted, but then everything changed.

We have always prioritized the safety of our investor's money and a conservative use of debt. Reflecting on these past few years, we have learned from this experience and will continue to make the best decisions we can with the best information we can gather.