Volume 35, No. 2, July 30, 2021

QUARTERLY UPDATE

CWS CAPITAL PARTNERS LLC

CWS Capital Partners LLC

CWS

CALENDAR OF EVENTS

September 6, 2021
Labor Day Holiday
CWS Offices Closed

September 15, 2021
3rd Quarter 2021
Est. Tax Payments Due

October 15, 2021
2020 Tax Return Extensions Due

October 29, 2021
3rd Quarter 2021
Quarterly Reporting Packages Mailed

November 25-26, 2021
Thanksgiving Holiday
CWS Offices Closed

December 24, 2021
Christmas Eve Holiday
CWS Offices Closed

December 27, 2021
Christmas Holiday (Observed)
CWS Offices Closed

January 3, 2022
New Year's Day Holiday (Observed)
CWS Offices Closed

50 CWS Enhancing Lives Years

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HERE COMES THE SUN

By Gary Carmell

As we have communicated over the past year, we felt as if we had built up strong defenses to help weather the Covid storm. Of course when it started we had no idea how bad it would get. What we did know, however, was that the Federal Reserve was going to aggressively lower interest rates to do its part to help the economy through the pandemic-induced shut down. And with approximately 83% of our debt being variable-rate, we would see a material drop in our interest costs. This, in combination with a temporary, yet material, reduction in our capital expenditures, would enable us to absorb whatever impact Covid would have on our revenues via lower occupancy and/or rents, non-payment, and the waiving of certain fees required by law.

Our revenues ended up coming in higher than expected as we collected approximately 98% of what we billed on a portfolio basis (of course individual properties could differ materially). Our properties tend to be located in lower cost, high growth suburban areas that benefited from the changing consumer preferences for housing with the overnight advent of remote work in the economy. Our residents also prioritized

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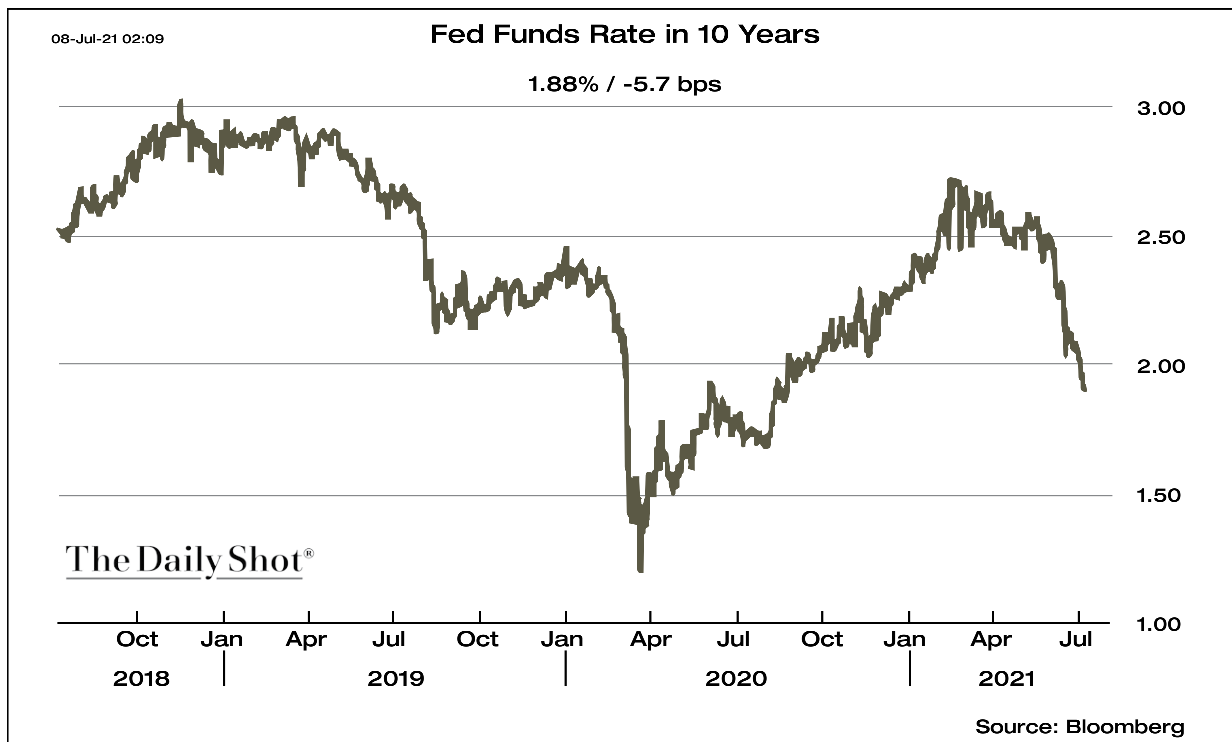
paying their rent and fortunately did not experience the hardship that so many others did who lost their jobs during Covid. Our revenues did drop approximately 5% in 2020, but our cash flow increased by approximately 50% as a result of much lower interest expense and reduced spending on capital projects. This enabled us to increase distributions on a portfolio basis while still maintaining healthy cash balances at our properties. This has continued to be the case even after absorbing another blow with the Great Freeze in Texas that damaged nearly 3,000 of our units. Fortunately, our insurance coverage has been adequate to fund the repairs and our Capital Projects teams have the skills and capacity to implement those required repairs under the close supervision of our Asset Management team.

Now that it would appear that the worst of Covid's impact may be behind us, absent a new, vaccine-resistant variant that is highly transmittable, we are optimistic about some of the trends we are seeing. On a macro basis we should continue to benefit from our variable rate exposure as the Federal Reserve is not expected to raise short-term rates until 2023 at the earliest, although some market indicators suggest it may be as early as late 2022. Given our average floating interest rate is approximately 1.80% right now, we are still quite a bit below the more typical 3% to 4% range that we have experienced. In fact, as the following graph shows, the market does not expect rates to be materially higher in 10 years.



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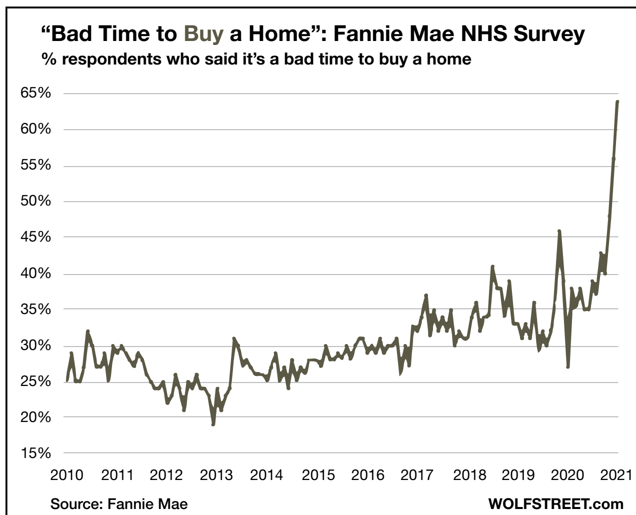
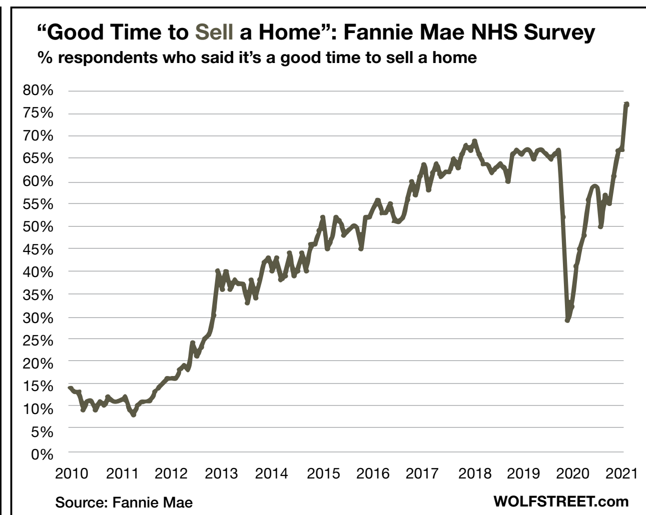
What's more important for us is what the average rate will be for 30-day LIBOR, which is the index upon which most of our floating-rate loans are based, although this will be going away in a couple of years and a new index will replace it. Based on mathematical calculations, one can interpolate what investors think future rates will be for 30-day LIBOR. Fortunately there are companies that carry out these calculations and share them with us. Based on the recent forward curve, 30-day LIBOR is projected to average 1.18% over the next 10 years. Based on our current weighted-average spread over LIBOR of approximately 1.70%, this would keep our average interest rate for our floating-rate loans at less than 3%, although obviously higher than what we're paying today by a bit more than 1%.

With more companies and workers seeing the benefits of being in the cities in which we're invested (e.g. Austin, Phoenix, Denver, Raleigh, Atlanta), we believe we are very well-positioned from a portfolio standpoint. In addition, despite the red-hot housing market, we may be seeing some concerns among prospective buyers due to affordability issues even with interest rates being historically low. The following charts display deteriorating optimism in terms of buying a home and a greater belief that now is an ideal time to sell a home.





Operationally we're starting to see the cloud layer lift and the sun shining through. On a portfolio basis our average rent per occupied square foot was $1.45 during the first quarter of 2020. Today, they are slightly lower at $1.44, but this is a bit misleading as it is masking some very strong recent growth. For example, the following table shows how our pricing power has improved materially over the last three months (April, May, and June).

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	New Resident Leases	Existing Residents Renewals	Totals/Averages
Number	3,679	6,433	10,112
% of Leases Signed	36.4%	63.6%	N/A
Average Rent	$1.68	$1.52	$1.58
Avg. Rent per Sq. Ft./Avg. Property Rent per Sq. Ft.	+16.7%	+5.6%	+9.7%

The rents being attained from new people moving in to our communities are materially higher than renewals. This is not atypical when markets are strengthening and it is more palatable to obtain much higher rents from new people moving in than from current residents renewing. Over time most units end up obtaining market rents as the average resident tends to stay about two years. There are other times when the opposite is the case when existing residents pay rents that are higher than new customers. As mentioned earlier, it tends to even out over the long-term. Overall, however, we are very pleased with the average rent being attained for new leases and renewals being close to a 10% increase as compared to the average in-place rent in our portfolio.

On a property-by-property basis some results are quite startling, particularly in urban areas. With that being said, however, they also got hit incredibly hard as people fled cities for less dense locations. So the real question is where were the rents, how far did they come down, and what is happening with new leasing activity?

The Clark is a very high-quality community we built that is located in urban Austin. It got off to a great start and then Covid hit. Here are some of the pertinent statistics comparing where we are today versus one year ago.

THE CLARK

	1st Quarter 2020	2nd Quarter 2021	Change
Occupancy	85.6%	95.3%	+9.7%
Average Rent per Sq. Ft.	$2.88	$2.55	-11.5%

Although The Clark's occupancy improved quite a bit, the average in-place rent dropped materially at 11.5%. The second quarter leasing activity was quite impressive however. Here is the same table as used above for the CWS same store portfolio but just for The Clark.

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THE CLARK

	New Resident Leases	Existing Residents Renewals	Totals/Averages
Number	52	40	92
% of Leases Signed	56.5%	43.5%	N/A
Average Rent per Sq. Ft.	$3.28	$2.93	$3.13
New Rent % Change vs Previous Rent	+24.6%	+5.4%	+16.3%
New. Rent per Sq. Ft./Avg. Property Rent per Sq. Ft.	+28.6%	+14.9%	+22.3%

One can see a similar phenomenon as the overall portfolio in that the new resident lease rates are quite a bit higher than current residents renewing their leases. This is probably overstating the gap, however, because the small number of leases signed for any one property can differ in the average size of the units whereas this is not an issue at the portfolio level. Larger units tend to command a smaller rent per square foot because customers are more focused on the absolute dollar of the rent, which can hit a ceiling for bigger units. The new resident leases were for an average unit size of 725 square feet, whereas for existing resident renewals they were 8% larger at 783 square feet, which makes the rent obtained for these units even more impressive. The average size of a unit at the property is 775 square feet so the renewals are more representative of the overall property.

One way of taking the unit size differential out of the analysis is to just look at how much the rent changed for the same unit compared to what the previous occupant paid or the current resident was paying on his old lease. New residents signed leases at rates that were 24.6% more than the previous ones and renewing residents saw their rents increase by 5.4% for a weighted average increase of approximately 16%. The increase for renewing residents was substantially less because the rents they were paying were quite a bit higher (12%) than those who vacated their units and left the community. This is a good thing because it brings existing residents closer to market rates and repopulates the community with residents who are able and willing to pay substantially higher rents that the departing residents could or would not. If these trends hold one year from now, then we will have recovered all that we lost and be substantially ahead of where we are today.

I'll give two more examples to show how what had stayed strong during Covid continues to

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gain even more strength as we come out of it. One is a property in the Phoenix area, Marquis Sonoran Preserve, and the other is in the Charlotte area, Marquis at Morrison Plantation.

MARQUIS SONORAN PRESERVE

	1st Quarter 2020	2nd Quarter 2021	Change
Occupancy	95.1%	95.9%	+0.8%
Average Rent per Sq. Ft.	$1.23	$1.34	+8.9%

MARQUIS SONORAN PRESERVE

	New Resident Leases	Existing Residents Renewals	Totals/Averages
Number	29	51	80
% of Leases Signed	36.3%	63.4%	N/A
Average Rent per Sq. Ft.	$1.73	$1.39	$1.51
New Rent % Change vs Previous Rent	+24.5%	+7.3%	+13.5%
New Rent per Sq. Ft./Avg. Property Rent per Sq. Ft.	+29.1%	+3.7%	+12.7%

MARQUIS AT MORRISON PLANTATION

	1st Quarter 2020	2nd Quarter 2021	Change
Occupancy	93.3%	97.1%	+3.8%
Average Rent per Sq. Ft.	$1.15	$1.20	+4.4%

MARQUIS AT MORRISON PLANTATION

	New Resident Leases	Existing Residents Renewals	Totals/Averages
Number	35	43	78
% of Leases Signed	44.9%	55.1%	N/A
Average Rent per Sq. Ft.	$1.47	$1.27	$1.36
New Rent % Change vs Previous Rent	+22.2%	+7.6%	+14.2%
New Rent per Sq. Ft./Avg. Property Rent per Sq. Ft.	+29.1%	+3.7%	+13.3%

Similar to the rest of the portfolio, these two properties had increases that were materially higher for new leases than renewals. Overall the increases were still impressive even with the

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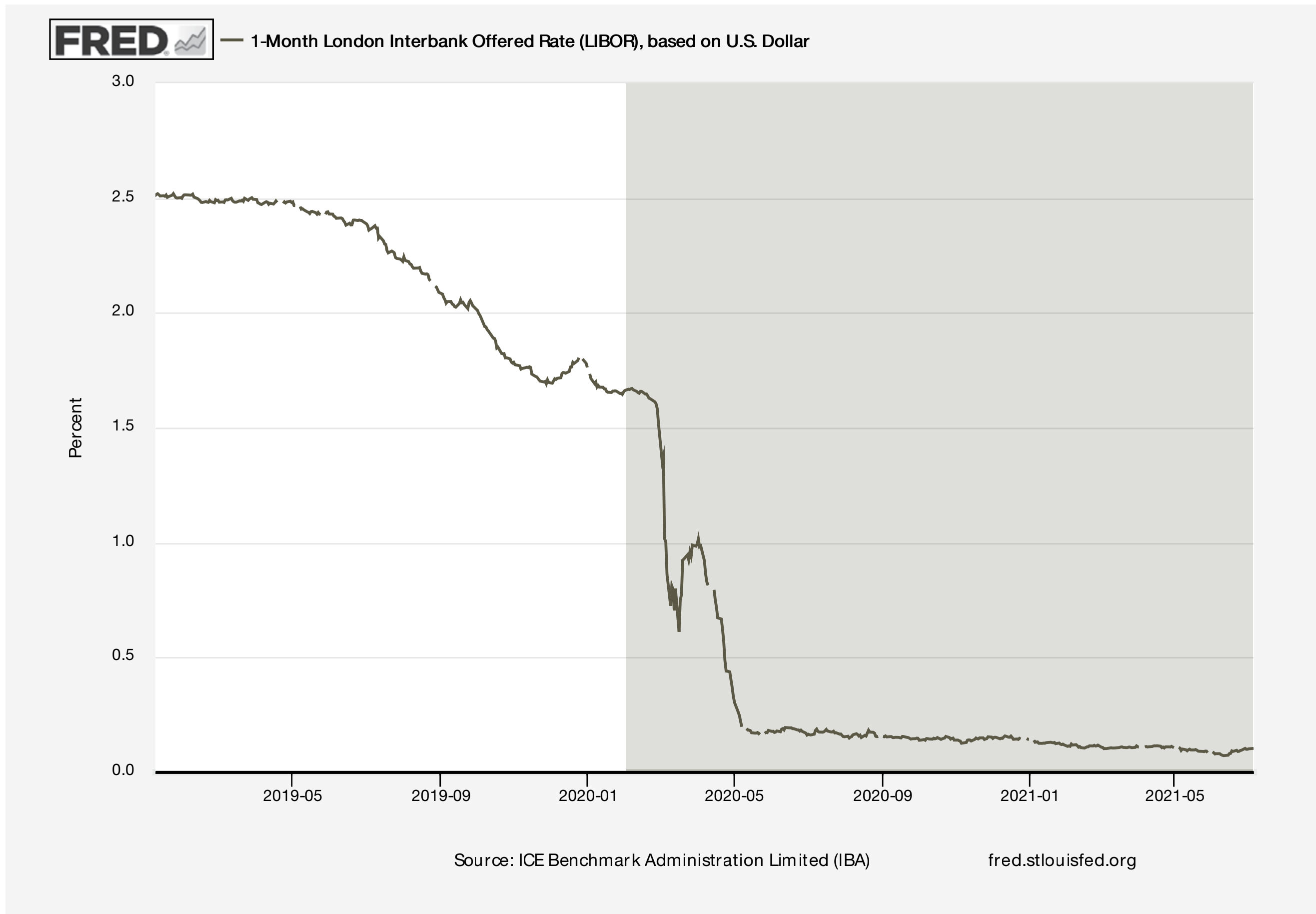
uninterrupted growth experienced during Covid. This was strength begetting more strength which was obviously an ideal set of circumstances, particularly since these two properties also benefitted from the lower interest costs from having variable-rate loans. One can see how 30-day LIBOR dropped precipitously during Covid and this benefitted not only these two properties (in addition to The Clark), but all of our floating rate loans.



Given the trends we are seeing, we are optimistic about our potential to grow revenues over the next year. And while we will not benefit from a drop in interest rates, since LIBOR cannot go much lower and our loan agreements don't allow us to capture any benefits from negative rates, we should still be in a relatively healthy position from a cash generation and working capital standpoint in case there is an unexpected drop in revenues, higher rates, or unanticipated material expenditures. The sun appears to be breaking through the clouds and we look forward to capturing some of the growth that its energy should bring. ■

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