Volume 27, No. 4, January 31, 2014

QUARTERLY UPDATE
CWS CAPITAL PARTNERS LLC

CWS Capital Partners LLC

CWS

CALENDAR OF EVENTS

March 2014
2013 K-1's Mailed

Friday, April 11, 2014
CWS Annual Partners Meeting
Newport Beach Marriott Hotel and Spa
Newport Beach, CA (Fashion Island)

Tuesday, April 15, 2014
2013 Tax Filing Deadline

Tuesday, April 15, 2014
1st Quarter 2014 Estimated Tax Payment Due

Friday, April 18, 2014
Good Friday
CWS Office Closed

Friday April 25, 2014
1st Quarter 2014
Quarterly Packages Mailed

May 2014
CWS Capital Partners
Semi-Annual Conference Call

Monday, May 26, 2014
Memorial Day
CWS Office Closed

Friday, July 4, 2014
Independence Day
CWS Office Closed

Tuesday, July 15, 2014
2nd Quarter 2014 Estimated Tax Payment Due

Friday, July 25, 2014
2nd Quarter 2014
Quarterly Packages Mailed

www.cwscapital.com

IS CWS RIGHT FOR YOU?

By Gary Carmell

A few years ago I came across letters written by Warren Buffett to his investors prior to Berkshire Hathaway being his sole investment vehicle. Between 1956 and 1968 Buffett was the general partner of various Buffett Partnerships. His performance was, of course, extraordinary and it is fascinating to see how the assets of the partnership compounded through a combination of investment acumen and new capital. I had the luxury to spend some time recently re-reading some of these letters. One of the things that struck me was how he consistently communicated how performance should be measured and, most importantly, how essential it is to have patience and not be overly influenced by short-term results. He continued to emphasize that his investment approach was designed to dramatically outperform during downturns in the market (which could mean losing less than the market averages) while being prepared to under-perform during up markets (which rarely was the case). This got me thinking that it's probably a good idea to communicate to our investors our philosophy regarding return expectations, time frames, etc. This is intended to help determine if CWS is a good fit for current and prospective investors.

CWS is not for everybody. In fact, we take a lot of pride in having a very unique business model that focuses on private investors while still having the scale and infrastructure of a firm backed by large pools of institutional

Continued on Page 2

Continued from Page 1

capital. Bill Graham, the legendary San Francisco rock promoter, once said of the Grateful Dead, "They're not the best at what they do, they're the only ones that do what they do." This is how I want CWS to be and as such, we cannot and will not appeal to everybody. To keep with a Grateful Dead theme, Jerry Garcia described Deadheads, rabid Grateful Dead fans, like this. He said, "People who like the Grateful Dead are like people who like licorice. Not everyone likes licorice, but those who like licorice really like licorice." That is what I have come to learn about long-term investors of CWS and some newer ones as well.

I will take a counterintuitive approach and first tell you all of the reasons why CWS may not be a fit for you and if you are still interested and believe that the objections are manageable then I will try to lay out all of the compelling reasons why CWS might be just right. It's somewhat akin to the belief that most people find negative reviews of a book or product to be the most helpful because often people will read them and say, "That's not that bad, or he or she is too picky or I can live with that." Once the negatives are out of the way, then people can be freer to open themselves up to the positives.

Who is CWS not right for?

If any of the following are important to you then I suggest we may not be a good fit:

You want real-time pricing for your investments

We value our investments once a year and attempt to be somewhat conservative in our valuations. For most of our investments the most pertinent real-time feedback is found in the quarterly dividends. We also do our best to have a conservative distribution policy that takes into consideration the possibility that performance may go backwards for a period of time, loans may start amortizing, we may have large capital projects for which we need to reserve, interest rates might rise, or something unforeseen may occur from an emergency repair situation such as hail damage to roofs that may have a large deductible.

You need or want quick access to your invested capital or have a short-term investment horizon (less than five years and usually less than seven to 10 years)

It is important that you do not need access to your money quickly since our investments are designed to be long-term in nature. The two traditional ways we provide liquidity for our investors are through sales and refinances (to the extent we borrow more money and make a distribution). These can take more than five years to materialize for most of our investments. If you need to sell your investments early, the price you will receive for your ownership interest will likely be less than what is stated in our Personalized Annual Investor Report (PAIR). The lower price is the result of an illiquidity discount caused by the difficulty to locate potential buyers to purchase your interests. Values stated in the PAIR are based on the entire property (or properties in the case of the Strategic Apartment Funds) being sold at the then current market values.

If you have a need for this money to cover future expenditures (e.g. college tuition, remodel, vacation, helping one's children, emergencies, etc.) in less than seven years, then we are probably not an ideal match. While we have sold properties in less time, we just would not want anyone to plan on it unless that was the stated business plan.

Continued on Page 3

Continued from Page 2

You don't like to be invested in properties which use borrowed money, despite the loans being non-recourse

Leverage (the use of borrowed money) is a double-edged sword as many like to say. It magnifies returns both up and down. Real estate, particularly apartments, is an asset class with a fairly reliable income stream which makes using borrowed money suitable to buy or build properties. Sometimes leverage can be excessive if the property doesn't perform as planned and the owners can be at risk of losing the property unless they can restructure the loan and/or bring in additional capital to support the investment. CWS consistently uses borrowed money to purchase and develop properties.

Variable rate loans - CWS is an aggressive borrower using variable-rate loans in which the interest rate can move up and down every month. We purchase interest rate caps but they are not for the life of the loan. I have written extensively on what CWS believes are long-term advantages of using variable-rate financing but we are definitely exposed to higher interest rates if and when the Federal Reserve starts adjusting the federal funds rate higher.

Loans that start off as interest-only and then amortize - Often times our loans in the first few years have monthly debt service that do not require principal repayments. Eventually, however, most of them do require that our payments include some principal repayment. When this takes place, the debt service can increase quite significantly. We are well aware of this when we put the financing in place and account for this in our projections. Nevertheless, it still results in a meaningful increase in the property's fixed costs and can be problematic if the property's performance has deteriorated when amortization (principal repayment) commences.

You cannot accept financially (or emotionally) the prospect for dividend cuts or the potential of needing to make unanticipated capital contributions

There are times when the operating performance is not strong enough to maintain distributions while still keeping the property competitive and the dividends need to be cut. In addition, all properties, particularly those in strong locations, will need to be upgraded every ten years or so (if not sooner) and this can require a lot of capital. Apartments have very good long-term earning power, but periodically they require significant capital reinvestment which may necessitate dividend adjustments.

If either financial performance drops below the breakeven point and there are not sufficient cash reserves to fund the deficit or the General Partner believes that a property would benefit from a substantial improvement program, then investors may be asked to make an additional investment to support the property until it reaches break even or to fund the upgrade program. Investors need to be prepared for this potential when making a new investment in one of our properties.

You are not comfortable being invested in Texas

CWS has had a strong focus on Texas since the late 1970s. We have been pleased with our concentration there for a variety of reasons but it is subject to economic cycles just like every other area of the country. It went through a terrible downturn in the late 1980s and early 1990s, suffered during the tech crash from 2001-2003, and wasn't immune to the effects of the Great Recession from 2007-2009. Nevertheless, we remain very bullish on Texas' economic potential and

Continued on Page 4

Continued from Page 3

will continue to invest in the major metropolitan areas there.

K-1s are too burdensome and complicated

Investing in limited partnerships creates some additional paperwork which needs to be incorporated into the investor's tax return. This can create more complexity and cost in terms of preparing the return. Some firms deliver their K-1s rather late, requiring investors to file an extension. If we are handling the accounting for the investment and there are no IRS or state delays in producing forms, then we almost always have them completed by March 1st of each year.

You don't have a positive view of apartments

CWS focuses almost exclusively on apartments so if you don't believe they represent compelling investments over the next decade or so, then it would be best if you deployed your capital elsewhere.

CWS or its affiliates earn various fees and performance incentives

CWS typically earns fees for acquiring, managing, refinancing, and disposing of properties. In addition, CWS may earn performance based fees through an affiliate that allows it to participate in the cash generated by the property and proceeds from sale and refinances once the investor has received a minimum annual return (typically 8%). If you do not feel these are warranted then it would be best if you deployed your capital with other firms or yourself directly.

You can't accept our return goals; Under-performance compared to stocks on a periodic basis is upsetting

Our goal is to double one's investment from a combination of cash distributions and appreciation over a five to seven-year period. In some years we will do better than the stock market and other years we will under-perform. One must be ok with the periodic under-performance.

Now if that wasn't too bad and you realize that there's no investment without some exposure to risk and uncertainty, then perhaps you fit into the category of CWS being right for you. Since I'm assuming that most people who read this are investors, then presumably we are right for you and have been over the years. Fortunately, with over 700 investors, a meaningful number of people have found that CWS is a good fit for them and given there are millions of apartment units in the country, then others have obviously found them to be compelling investments as well.

Who is CWS right for?

If any of the following are important to you then I suggest we may be a good fit for you:

You value illiquidity

I like to say that CWS helps save people from themselves. Many of our investors recognize that successful investing is tough to do over a long period of time. We're susceptible to immense psychological forces that can often lead us to sell at the bottom and buy at the top. By having one's money tied up with CWS, one hopefully lessens the risk of getting in their own way because either they're bored and don't have enough to do, they are not interested in monitoring

Continued on Page 5

Continued from Page 4

their investments, they're indecisive, lack discipline, or tend to be impulsive with their investment decisions. Not that we're perfect by any means, but if we do our job right, then hopefully you can achieve better outcomes than you otherwise would with a lot less worry. Illiquid investments also have a better potential to have one's capital compound by having it invested longer in strong real estate investments with durable cash flows that the sponsor (CWS) controls.

You like real estate, especially apartments

Historically, real estate is a very good way to store, preserve, and grow wealth. This is the case for well-located properties that are maintained well because real estate is typically a byproduct of economic and demographic factors. The United States, particularly in dynamic cities with a well-educated work force, is able to innovate and grow over the long term, despite periodic setbacks. Real estate naturally benefits from this growth. Since not everyone can or desires to own a home, there will always be a demand for rental housing, especially for those communities close to jobs and transportation corridors.

You recognize the tax benefits

Often times most, if not all of the cash distributions can be sheltered from having to pay current taxes due to deductions for depreciation.

1031 exchange - Property owners that meet certain IRS requirements can continuously defer paying taxes associated with gains generated by selling properties if they reinvest their proceeds via 1031 exchanges. This can allow for tremendous pre-tax wealth creation.

Excellent estate planning tool - Distributions made over the years along with depreciation deductions build up an increasing potential tax liability when it comes to time to sell. This makes using the 1031 exchange a very powerful and attractive wealth preservation vehicle. At some point, however, after the investor passes away, then his or her heirs can inherit the investment(s) based on the fair market value of the investment, less any discount for owning an illiquid, minority interest. This can wipe out most, if not all, of the ever growing tax liability that had been building up over the years while the investor was alive. The heir(s) now own the investment typically at a much higher tax basis which will result in a lower gain on sale when the investment liquidates. In addition, to the extent the estate of the deceased was large enough to have to pay estate taxes, this burden can be lessened by applying the illiquidity/minority discount when it comes to valuing it for estate tax purposes.

You like leverage and acknowledge its advantages

The loans CWS accesses are non-recourse to the limited partners, meaning there is no liability to the limited partners to repay the loans. The lender can only look to the collateral of the property or other pledges made by the General Partner or affiliate.

Using borrowed money can magnify the returns because loans only have a fixed claim on the cash flow and sale proceeds and do not participate in the profits. Thus, if the investment earns a greater return than the cost of the debt, then the investor's return will be magnified.

Using borrowed money allows the partnership to purchase a larger property than it otherwise could. This makes it much more efficient to manage and provides for a higher return potential because more of an increase in revenues should be able to fall to the bottom line as compared to a smaller property.

Continued on Page 6

Continued from Page 5

The purchase of a larger property using borrowed money allows for more depreciable assets per dollar investment, thereby providing more shelter of one's distributions from immediate taxation.

Some lenders allow borrowers to borrow more money if the property's performance has improved. This is particularly helpful when a property could benefit from a significant investment to upgrade the community. Without debt, the burden would fall on the current investors to fund the capital needed to carry this out. With the right lender, they can be the one to advance this additional capital.

You value yield

Real estate is typically purchased to generate current dividends which are typically higher than what is available in the stock market or bond market. This is the case because most properties are limited in terms of expanding their capacity to generate more revenue other than by raising rents. It's rare that more units can be created. Given this, real estate investors tend to want approximately half of their total return to come from dividends and the rest from capital appreciation.

You prefer a tangible asset

Owning property is obviously tangible and is unique because of the owner's ability to improve upon it and add value.

You recognize real estate as an inflation hedge

Real estate has generally proven to be a hedge against inflation. As excess money is created, it needs to find a home and real estate is one of the most desired asset classes when this is the case. Apartments are particularly well-suited because the average lease term is approximately 11 months, so it's easy to reprice the apartments in an environment of escalating rents given the relatively short lease terms, especially when compared to office, retail, and industrial properties.

You take comfort in the fact that values are not susceptible to the daily volatility of the stock market

We value our investments once a year as compared to freely tradeable securities whose prices fluctuate minute by minute. Not worrying about daily valuations can take a lot of the emotion out of investing and allow one to focus on adding value each day without being distracted by highly volatile market fluctuations.

You believe the sponsor should control cash flows to ensure properties are operated efficiently

I believe that having directly owned and managed properties over the years has made CWS much better decision makers and business people. We have to deal with real world problems versus evaluating management teams from afar as many stock and bond portfolio management teams do. We are more grounded and can use our vast amount of experience to evaluate opportunities, risks, and separate the signal from the noise. We can also take direct action to add value to our investments because we control the cash flows.

You are comfortable with Texas

CWS has a large percentage of its investments in Texas and we will continue to remain focused on growing there. We like the growth prospects, favorable business climate, unique energy capabilities, and strong and growing medical infrastructure. We also

Continued on Page 7

Continued from Page 6

like the technology strengths and access to Mexico, Latin America, and Asia. Texas is also seeing strong in-migration due to many of the factors listed above.

You value being educated

We do our best to bring our investments and thought processes to life for our investors. We think it's important for our investors to know why we're taking the actions that we're carrying out (or actions we're not taking) so that we can minimize surprises. This allows our investors and prospective investors to determine whether this is the train on which they want to stay (or board) and whether or not they like the direction it's going.

You value access to decision makers

We think it's important for investors to have their questions answered and, if necessary, to hear the answers directly from the key decision makers. We take great pride in the environment we've created with our investors in terms of our transparency and focus on delivering information that is timely, relevant, and accurate.

You prefer to be a passive investor

Real estate investment requires a lot of work, focus, and potentially capital to maintain properties the way they should to maximize their locational value in order to attract and retain the best quality residents who have the ability and willingness to pay escalating rents in the future. This is not easy to do well. CWS investors do not need to be burdened with this responsibility since their investments are completely passive. Thus, ideally, our investors can gain all of the benefits of owning real estate without the associated headaches.

You feel our target returns match with your investment goals

Our goal is to come close to doubling an investor's money between cash flow and appreciation over a five to seven-year period.

So there you have it…These are all of the reasons I could think of to hop on the CWS train (or stay on the journey) and some of the factors that may convince you to keep on the path you've been going down independent of CWS. I hope you will find yourself aboard with over 700 other investors who have elected to take this trip with us. Given that the bulk of my net worth is invested in CWS investments I can say personally that I have been delighted with the experience and results. Of course I'm biased but at least I'm eating my own cooking and I'm enjoying how it tastes and its nutritional value.