PWL
PACIFIC WEST LAND™

October 2022 Update

As I write this, our thoughts are with all our friends and investors in Florida, most of whom are in the Fort Myers area. We know they are going through a very difficult time, and we are praying for them. We will be looking for opportunities to help in a substantial way in the coming weeks.

Pacific West Land is sponsoring the **Stella Maris House** **Star of Hope Gala** on Saturday, November 19th at the Kitsap County Golf and Country Club. Stella Maris House is one of Kitsap County's two shelters for women and children. The organization also operates a food bank. If you would like to join our table as a guest, please RSVP to Caroline. For more information on this vital community organization, check them out on Facebook.

For over a decade, PWL has used Microsoft Great Plains accounting software and Microsoft's Customer Relationship Management (CRM) software. We were using the Great Plains accounting software before Microsoft acquired the company. I've read that over 70,000 mid-sized companies also use this software platform.

Last year, we began getting startling warnings running across the tops of our accounting and customer relation management (CRM) screens from Microsoft telling us that our system would stop working shortly, would no longer get technical support, and that we needed to move to something called Dynamics 365. These warnings were surprising, because Microsoft never posted anything that said, *"Here's why this change is a great idea for you, our customer."* Instead, in engineering-speak (MSFT executives love to misuse the word "deprecate"), customers like us who asked "*why?*" were told it is mandatory that we make the expensive, time-consuming, and scary software change; that's it. Microsoft, to the best of my knowledge, has never answered the question "why", spelling out any potential customer or product benefits, or providing guidance on contractors who could smoothly help us with the mandatory transition. We were given an order, not a sales pitch. **Monopolies breed the worst marketing habits.**

After considering the change Microsoft demanded, we decided to go in a different direction. We are now in the process of migrating our data to an accounting and CRM software platform from a different vendor. The migration is going well. Our accounting team has been learning the new software and retooling dozens of daily, monthly, quarterly, and annual accounting tasks and reports. They tell me the new software is easier to use, and that they are enjoying the process of climbing up the learning curve. They have been super in taking on this challenge. Later this year, we will migrate about 15 years of CRM data. Please join me in a collective <*knock on wood*> that this all goes smoothly.

When we started publishing these updates 18 years ago, we would often explain verbiage and concepts common in commercial real estate. When considering topics for this monthly update, I'll think to myself, "that's something we must have covered." After some research, we found that we did cover the thought on my mind more than a decade ago. "It couldn't have been that long," I'll think.

Some lessons are worth repeating, at least every 10 years. This month we're going to review something we wrote about many moons ago, **capitalization rates or cap rates**. This describes a very simple mathematical ratio that allows us to make a superficial comparison of any two commercial properties. Note, in the real world, no one ever says or writes "capitalization rate". Capitalization rate is one of those terms limited to textbooks and academic papers. **In the real world, we exclusively use "cap rate."**

Current Income ÷ Purchase Price = Cap Rate

If a property is currently generating $90,000 per year, and that property sells for $1,000,000, then we calculate it has a cap rate of 9%. Cap rates are always expressed as a percentage.

Cap rate is handy because it allows us to compare different real estate investments quickly. A Manhattan skyscraper might sell at a 3.4% cap rate, while a shopping center in Renton goes for 7.4%. This predicts investors will enjoy twice the cash flow on their Renton investment when compared to their Manhattan investment. When buying a property, an investor determines how low a cap rate is acceptable, and therefore how high a price to bid. Cap rate is, by definition, inversely proportional to price.

Cap rates are based on in-place income. When a property is being marketed, the current rent roll and current expenses are used to project the coming year's income. This defines current income in the formula.

We only know a cap rate on the day a property sells. At all other times, we are estimating the value of the property using cap rate as an input, not an output. In other words, at the time of a sale, cap rate is the dependent variable. At all other times, cap rate is an independent variable. We know a property's income. We observe the cap rates of comparable sales. We use these two factors to estimate a property's value.

Current Income ÷ Estimated Cap Rate (from comparable sales) = Estimated Property Value

However, cap rate draws an incomplete picture. First, let's imagine we're considering buying a property with $300,000 of income, but it needs a $250,000 roof. Future capital expenses do not show up anywhere in the cap rate formula.

Next, let's imagine we're considering buying a property with $300,000 of income, but the property is 20% vacant. The income that could come from filling vacancies does not show up anywhere in the cap rate formula. You may have heard us say something like, "*We bought it at an 8-cap, but got 12% vacancy for free*." OK, the vacant space is not really free. It's just not included in the cap rate formula. We give an answer full of real estate slang when people always ask us, "*What cap rate did you pay?*" Another possible answer, "*We paid a 9-cap, but it needs a roof,*" implying the cap rate sounds high, which would mean we got a deal, but that deal may be reduced or eliminated by the cost of deferred maintenance.

When considering a purchase or when to sell, we create a detailed mathematical model. This model estimates the future cash flow of the property by factoring in the major inputs that cap rate misses, like future vacancy, rental increases, capital expenditures, etc. We buy based on the return we believe we will achieve for investors, the odds that we are correct, and the pain factor if we are wrong. Both the going in and exit cap rates are in these models. Both are key factors, but they are not the only important factors.

We do not confuse cap rate with yield. Yield is how much an investment has or will distribute in a period to investors. Yield is always presented as an annualized amount expressed as a percentage. Capital expenditures have to be paid before distributions; therefore, these expenses reduce yield. As mentioned above, these same capital expenses do not affect cap rates.

We never confuse cap rate with return. Cap rate is a measurement made at a discrete moment in time. Return is how much money is or may be put in our wallets. Total return can be expressed with (IRR) or without a time component. Total return can be expressed as a straight percentage representing the whole return period, "*We doubled our money*," or an annual average, "*We made 20% a year*." When buying an investment property, we do make a conservative prediction about the future returns, but always with the advisory, "***this is a plan not a promise***."

Investors often get fixated on cap rate. Cap rate is shorthand for making comparisons, but it is not a good basis in isolation for making an investment. Overall return is not controlled by the cap rate on the day of purchase. While this is one important factor, it is not the whole show. A building with one tenant sells for a very low Cap rate, calculated from a meager near-zero income: revenue slightly more than expenses. Low cap rates translate to expensive prices, so a very low cap rate must mean a property is really valuable, right? Not so fast my friend, if this building never gets filled, it may only cost investors' money. If this same, mostly vacant, building is later occupied with good tenants, it could be a terrific outcome for investors. A single cap rate cannot accurately describe these opposite potential results. Despite this, every commercial real estate property listing headlines cap rate as though this one number tells the whole story. **Being overly focused on cap rate will obfuscate all the other factors in successful real estate investing.**

During a period of rising interest rates, we expect cap rates to also increase and therefore property values to decrease. This cycle, cap rates on commercial properties have not moved much. Recent interest rate increases would normally push cap rates up, but this has been mitigated by two forces. First, there is an epic amount of institutional capital looking to buy real estate as a shelter from inflation. Second, there is less supply of commercial real estate for sale than has been normal. In part, this is because current owners seek to remain sheltered during the current inflationary storm.

Jason Zweig is one of my favorite columnists at the Wall Street Journal. He writes "The Intelligent Investor" each week. He has some gray in his beard, a wide streak of common sense, and is primarily concerned with individual investors. I recommend his column of July 29, spotlighting iBonds. Zweig highlights the attractiveness of iBonds in a high interest rate environment. This column has been both in front of and behind WSJ's paywall, so you may or may not be able to read the whole thing.

If you would like to meet for breakfast or lunch, please give me a shout so we can get something on the books. Office visitors with an appointment, even with short notice, are welcome.

Stay healthy & keep smiling –

Martin A. Stever
President
martin@pacificwestland.com
(206) 780-3944 direct
(206) 780-4040 office

Sally Erickson
Investor Relations & Marketing Manager
sally@pacificwestland.com
(206) 201-3212

PWREI Scorecard

Approximate investment by PWREI
Data as of 8/31/2022

Willow Hill Center

The 21,082 sq. ft. center located in Puyallup, WA was purchased in May 2014 with an 83% stake for PWREI. We sold the Starbucks pad in October 2014 for ~$2.35M net and the Ivar's pad in April 2015 for ~$1.27M net. The property currently has 9 tenants with the most recognizable being Moneytree, Pho Tai Vietnamese, and Rainier Growlers.

Initial Investment	Net Investment	Occupancy	2022 Q1-Q2 NOI
$5,625,000	$2,897,139	100%	$221,793

Benjamin Square

PWREI purchased this 9,950 sq. ft. property in May 2014. Benjamin Square is in a highly visible center just off I-5 in Woodland, WA. The property currently has 6 tenants; the national tenants include Starbucks (drive thru), Subway, Papa Murphy's, T-Mobile and H&R block.

Initial Investment	Net Investment	Occupancy	2022 Q1-Q2 NOI
$1,900,000	$2,020,457	86%	$82,532

Auburn Road

Located in Dacula, GA, this 8,400 sq. ft. property was purchased by PWREI in August 2014. The center is located at the busy intersection of Auburn Rd. and Jim Moore Rd. and is at the center of a sprawling residential area. Auburn Road's 4 tenants include State Farm, Intracore Healthcare, Georgia Veterinary, and Center Stripe Golf.

Initial Investment	Net Investment	Occupancy	2022 Q1-Q2 NOI
$1,000,000	$1,043,791	100%	$51,861

Gulf Breeze

PWREI purchased this 27,739 sq. ft. property located in Port Arthur, TX in January 2015. The property is shadow anchored by the major grocery store, H-E-B, and maintains great visibility from both HWY 347 and HWY 365. Gulf Breeze's national tenants include Edward Jones, Sprint, World Finance, Super Cuts, Republic Finance, The Nutrition Store, Pizza Hut, and a Wells Fargo ATM.

Initial Investment	Net Investment	Occupancy	2022 Q1-Q2 NOI
$2,677,500	$2,874,743	100%	$246,545

Log Pond Plaza

Located in a dense residential area just north of State Route 16 in Newark, OH, this 27,368 sq. ft. property was purchased by PWREI in March 2015. The property is shadow anchored by a Walmart Super Center with a Home Depot across the street. Log Pond boasts a healthy mix of 11 local and national tenants, which include Hertz, Cheng's Chinese, Fiesta Salon, and CATO.

Initial Investment	Net Investment	Occupancy	2022 Q1-Q2 NOI
$1,850,000	$2,151,567	84%	$98,393

Massard Farms

Located in Fort Smith, AR, this large shopping complex was purchased in April 2015. In September 2018, the Kohl's building sold for $8.9M net. After its sale, PWREI still owns 71,592 sq. ft. leasable space. Massard Farms tenants include an IHOP, Savers, Sports Clips, Firehouse Subs, and Pad Thai Cuisine.

Initial Investment	Net Investment	Occupancy	2022 Q1-Q2 NOI
$13,415,287	$7,333,966	96%	$278,487

Massillon Commons

Located along the busy Lincoln Way corridor in Massillon, Ohio, this property was purchased in June 2015 for a 66.7% stake for PWREI. In June 2016, the Home Depot pad sold for ~$9.36M net with the proceeds used to pay off debt. In addition to a 50,503 sq. ft. Dunham's Sports, Massillon Commons boasts 63,048 sq. ft. of leasable space that includes 12 tenants, the largest being P.S. Cook's, OakPark Preschool, and Stark Medical.

Initial Investment	Net Investment	Occupancy	2022 Q1-Q2 NOI
$8,618,667	$2,456,425	91%	$131,851

Greensburg Commons

Purchased in July 2015 for a 66.7% stake for PWREI, this large 88,953 sq. ft. shopping center is located at the intersection of I-74 and State Rd. 3 in Greensburg, IN. In December 2016, the Walmart parcel sold for ~$13.9M net with most of the proceeds used to pay off debt. Greensburg Commons holds a mix of 15 local and national tenants. The most recognizable tenants are Jimmy John's, Great Clips, GameStop, GNC, Rent-A-Center, Feeder's Pet Supply, Goodwill, Open Box Outlet and Bath & Body Works.

Initial Investment	Net Investment	Occupancy	2022 Q1-Q2 NOI
$12,512,000	$3,644,190	91%	$165,983

Gateway Center

PWREI purchased this 28,056 sq. ft. mixed retail space, located in Newberry, SC, in October 2015. Gateway Center sits at the intersection of US 76 and Main St. and is shadow anchored by a Walmart. With 12 tenants, the center's most notable occupants include GameStop, Quick Credit, Nexien, and T-Mobile.

Initial Investment	Net Investment	Occupancy	2022 Q1-Q2 NOI
$2,030,055	$2,233,215	100%	$189,027

Powder Springs

Purchased in October 2015 by PWREI, this 15,050 sq. ft. strip center is located on Richard D. Sailors Pkwy in Powder Springs, GA. Upon purchase of the property, we acquired a vacant pad that was sold in February 2016 for ~$280K net. Powder Springs is shadow anchored by a Home Depot and has a total of 6 tenants including Hanger Prosthetics and Premier Martial Arts.

Initial Investment	Net Investment	Occupancy	2022 Q1-Q2 NOI
$1,100,000	$997,146	81%	$82,482

Sugarcreek Crossing

Located in Centerville, OH, PWREI purchased Sugarcreek Crossing in October 2015 and holds a 66.7% stake. Upon purchase, the property included three parcels: a ground leased Cracker Barrel pad that was eventually sold in May 2016 for ~$2.28M net; a Tire Discounters pad that was sold in December 2016 for ~$2.96M net; and a multi-tenant retail building containing a UPS store, a Chiropractic office, and Edward Jones, among others.

Initial Investment	Net Investment	Occupancy	2022 Q1-Q2 NOI
$5,117,333	$2,135,840	82%	$98,483

East West Market

Purchased as a joint deal with Castleberry Promenade, PWREI acquired this 17,017 sq. ft. property in February 2016. East West Market is located along the East West Connector in Austell, GA. The 1.09-acre Dunkin Donuts pad sold in June 2020 for ~$522K net. The property currently holds 6 tenants, the largest being WellStar Health System, American Hearing Imaging, and Thumbs Up Diner.

Initial Investment	Net Investment	Occupancy	2022 Q1-Q2 NOI
$2,660,000	$2,206,308	100%	$155,187

Castleberry Promenade

PWREI acquired this 26,651 sq. ft. property in February 2016 as a joint deal with East West Market. Castleberry Promenade is located at the busy intersection of Bethelview Rd. and Castleberry Rd. in Cumming, GA. Upon purchase, the property included leasable space as well as two small developable pads. This property currently has 10 tenants, among them Liberty Tax, Kumon Learning, Castleberry Ale House, and Ovo Salon.

Initial Investment	Net Investment	Occupancy	2022 Q1-Q2 NOI
$2,906,000	$3,207,943	100%	$202,616

Village at Las Sendas

PWREI purchased this 39,144 sq. ft property in June 2016 for a 33.4% stake. The Village at Las Sendas is located at the intersection of McDowell Rd. and Power Rd. in Mesa, AZ. This shopping center has a diverse mix of 16 national and local tenants, with the most recognizable being Chipotle, Jimmy John's, and Smashburger.

Initial Investment	Net Investment	Occupancy	2022 Q1-Q2 NOI
$2,922,500	$3,012,222	100%	$127,119

Little Corona – SOLD August 2020

Located at the busy intersection of Rural Rd. and Ray Rd. in Chandler, AZ, this 6,074 sq. ft. property was purchased by PWREI in December 2014. Little Corona was sold in August 2020 for $1.57M. At the time of sale, Little Corona held 100% occupancy.

Initial Investment	Profit	Deal Multiple	Gross IRR
$1,010,000	$1,170,646	1.82x	13%

Dail Center – SOLD August 2020

Dail Center was purchased by PWREI in December 2014. This 16,145 sq. ft. center is located along US Route 17 in famous Myrtle Beach, SC. Due to its popular location, the area attracts over 14 million visitors each year. In August 2020, Dail Center was sold for $2.4M and was 100% occupied.

Initial Investment	Profit	Deal Multiple	Gross IRR
$1,522,500	$1,990,807	2.08x	16%

Roosevelt Place – SOLD November 2021

This 14,000 sq. ft. property was purchased in August 2014 by PWREI. The property is located in the industrial corridor of Phoenix, AZ by I-10. This location allows for heavy daytime traffic. In May 2016, the Jack in the Box pad sold for ~$1.08M. Roosevelt Place sold in November 2021 for $5.02M.

Initial Investment	Profit	Deal Multiple	Deal IRR
$2,960,000	$4,620,030	2.55x	19.9%

Shoppes at Buford – SOLD June 2022

This 20,844 sq. ft. property was purchased by PWREI in May 2014 and is located in Buford, GA. The centers' location across from the Mall of Georgia puts it in a retail corridor ideal for drawing shoppers. Shoppes at Buford sold in June 2022 for $5.7M.

Initial Investment	Profit	Deal Multiple	Deal IRR
$2,740,600	$5,699,583	2.68x	15.1%

Oak Creek Commons– SOLD June 2022

This small 10,462 sq. ft. strip center located in Oak Creek, WI was purchased by PWREI in May 2015. Being south of Milwaukee, the area's population growth and average household income are projected to outpace the national average over the next five years. Oak Creek Commons sold in June 2022 for $2.5M.

Initial Investment	Profit	Deal Multiple	Deal IRR
$1,191,750	$2,499,248	2.81x	18.4%

Note: 2022 NOI numbers reflect the PWREI's portion of the total. All profit, NOI, Gross IRR, and Deal Multiple calculations presented are unaudited gross estimates. All numbers within this report are unaudited and should be considered as close approximations. Members receive audited results on an annual basis from a PCAOB registered public accounting firm.