



EDGEWOOD REALTY PARTNERS, LLC

Dear partners and friends,

As *Edgewood Realty Partners* embarks on its seventh year, and *The Kutzer Company* on its nineteenth year, we continue to look for opportunities to help our investors and clients make and manage their real property investments. Our investors and clients are a diverse group of institutions, companies, and individual investors. While their outlooks, profiles and personalities are often very different, they all have two things in common. First, they all like making money on their investments. And second, they are enjoyable to work with.

That is the reason for this letter. In all this time, our goals and principles which guide us in all of our investments have not changed:

1. Generate annual compound returns greater than 12% on cash invested. This 12% goal consists of two components, operating cash flow and equity appreciation. Historically, 12% is an attractive return for investments in stocks, bonds, and real estate. Indeed, the compound annual return for the broad stock market indices over the past century is around 10%. Most mutual funds fail to outperform the S&P 500. Of course, the past decade has been very disappointing for stocks.

2. Generate annual yields of 8% to 9% on cash invested. Therefore, if you invest \$100,000, our goal is to send you distribution checks totaling \$8,000 per year or more. We like properties that begin paying cash returns sooner rather than later. While appreciation in property values is important (and can be the source of real “home run” investments), generating fairly predictable cash flow is the hallmark of a good, long-term real estate investment. Cash yields also tend to smooth out the more unpredictable swings in property values through “hot” and “cold” market cycles. This goal has the very positive side effect of making it difficult to overpay for a property based on distant projections.

3. Own properties that are well run and maintained. This may sound like a goal for investors in companies, but we believe this is just as important for real estate investors. We view every property as an ongoing business enterprise, with numerous stakeholders, including our customers (the tenants), service providers (managers, vendors, and contractors), and the community. We have found that properties that are operated well outperform the market, and produce an added benefit of creating positive momentum in the surrounding community, leading to higher rents and investment returns.

Investment Principles

These are the key principles which will guide our investments.

1. Our money is invested with yours. We will invest in every deal ourselves. Lots of research by academics confirms the common sense wisdom that people perform best when rewarded for strong performance.

2. We will buy well-located properties, with stable (and improving) demographics, easy access, and good business prospects. Now, we have never heard anyone boast of specializing in poorly located properties. Nonetheless, there certainly is no shortage of such product. By the way, it is important for you to know that we do not necessarily mean “high-income neighborhood” when we say “well-located”. We would generally prefer a shopping center at a signalized, corner location near the freeway in Duarte, than a hard-to-find, difficult to get to shopping center on a minor street in Beverly Hills.

3. We prefer properties that have at least one relatively large, economically strong or “anchor” tenant. Properties with nearby anchor tenants often outperform unanchored properties over the long run. This is often due to the fact that anchor tenants are better able to weather recessions than smaller tenants, and are able to pay rent increases – sometimes substantial ones – during economic expansions. In shopping centers, anchor tenants generate customer traffic for the smaller tenants. Also, anchored properties generally qualify for more attractive financing terms.

4. We will use debt prudently. William J. Poorvu, Pete’s real estate professor at Harvard Business School and a very successful investor in his own right, wrote on the blackboard one day:

$$\text{Real Estate Investment} = \text{Property} + \text{Debt}$$

What Prof. Poorvu meant, of course, is that no matter how good the property is, you can create a lousy investment if the debt is poorly structured. Witness the huge losses experienced by many large investors in the early- and mid-1990’s, and again recently, when they borrowed too much money, at high interest rates. Conversely, even a mediocre property can generate satisfactory returns if the terms of its debt are attractive.

Today is - once again - a relatively attractive time to borrow money for real estate investments by historical standards, for the right sponsor and property. Recently it was difficult to find real estate lenders, the loans had to be personally guaranteed by an individual, and the interest rates were often above 10%, on a variable basis. Today, on good quality property, we still have a number of lenders who are willing to lend on a non-recourse basis (limited personal guarantees), at interest rates of between 4.5% and 5.5%, fixed for 7-10 years. To illustrate, if you had bought a property with an initial yield of 10%, with a loan of 75% of the purchase price, carrying an interest rate of 10%, your yield on cash invested would be 10%.

Today, if you paid more for the same property, say at an 8% yield, but secured a loan carrying an interest rate of 6.5%, borrowing 75% of the purchase price, your yield on cash invested would be 12.5%. So, even though you would have paid approximately 25% more for the property today, your return on cash invested would actually be almost 25% higher because the interest payments today are lower.

5. We will invest in properties that can benefit from some improvements. Our experience is that direct, “hands on” operations by our managers results in better investment performance. We will exploit “value added” opportunities where they exist, generally by way of physical improvements to the property, re-leasing to better tenants, and reducing expenses. The objective in all cases will be to increase cash flow, and property value.

6. We will invest for the long-term. It is not easy to find good properties to buy, nor is it easy to buy them at prices we believe are attractive. Therefore, when we find and make good investments, we will generally avoid selling them quickly so long as we anticipate continued, steady cash flow. Also, we don’t plan to retire for quite some time, and intend for Edgewood Realty Partners and The Kutzer Company to survive us. So, barring our sudden, unforeseen demise, we hope personally to provide good investment opportunities well into the future.

7. We will undertake development at a property only when we have good, strong tenants who will lease the bulk of the space upon completion. Making a lot of money on speculative development may be fun, but we need to be able to sleep, too.

8. We will be candid in reporting investment results to you. As your partners, we owe you no less. Accurate reporting is also critical in making good decisions. To quote Warren Buffett, “the CEO who misleads others in public may eventually mislead himself in private.”

If you share these goals and investment principles, we welcome you to join with us in future investments.

Best regards,
Pete Kutzer
Pete Kutzer
Managing Member

Joe McNulty
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