2021 Annual Letter

"Boring progress compounds into exceptional results"
Shane Parish

January 1, 2022

Happy New Year to everyone. Before looking ahead to 2022 and beyond, I thought it would be useful to reflect back on the journey thus far. Capital Allocation Partners ("CAP") was started 12 years ago in the depths of the financial crisis. Arizona was at the epicenter of that crisis, so the firm was born out of extreme circumstances. During the last 12 years I had the best intentions to write an annual letter to investors to describe CAP's strategy and reasons for existence, but I always seemed to find myself furiously working on the day-to-day operations of the business. In the last 12 years, Capital Allocation Partners has grown from a start-up alternative investment asset manager ("ALTAM") with a Fund of $500,000 to a mid-sized ALTAM with over $100 million under management in six active Funds and several joint ventures ("JVs"). Due to this growth, CAP also went from a place with an extremely small investor base of friends and family, to a larger investor base of accredited investors that I have never met and/or know only casually. Therefore, I am going to try and write a succinct annual letter from now on to do my best to communicate to this much larger investor group. Additionally, we still intend to announce important updates throughout the year via email and share acquisitions/dispositions content on CAP's LinkedIn.

Finding the Why

CAP was created out of frustration and general disdain for the way most existing Private Equity and Hedge Funds operate (herein referred to as "Traditional ALTAMs"). When I scanned the Traditional ALTAM space, what I always saw was a place where the asset managers got paid extreme compensation (generally through guaranteed fees) regardless of the outcome of the investments while investors were getting meager returns and sometimes were being outright fleeced. As someone who always admired Warren Buffett and Charlie Munger and what they have created at Berkshire Hathaway, I decided that CAP would be different. So how is CAP different? CAP has no ongoing fees, payroll, management costs, rent, administrative fees, etc. passed through to the Funds. The assets of the Funds exist to invest and when the investment has gone full cycle, they are reinvested into new assets or distributed out to the investors depending on the Fund or timeframe. Any costs to run CAP are paid by the Manager (myself/CAP) and not stuffed or passed through to the Funds or limited partners.

After 12 years how has this system worked vs. the Traditional ALTAM investment returns? Let's just say we are lapping Traditional ALTAMs repeatedly and I don't see this changing anytime soon. When you create a system with lower costs and a better deal for the investors, it's a bit like creating a flywheel. However, we are not altruistic. We believe investor and manager returns will

be maximized if our interests are aligned, so it's the right thing to do, and it's the optimal thing to do. Our high returns and significant AUM growth over more than a decade bear this out. **Industries where participants are fat and happy and are generally fleecing the customers are ripe for disruption. We like being the disruptors rather than the ones being disrupted, so we will continue our journey of being a non-traditional ALTAM firm with a successful and fair structure.**

Active Funds

We currently are investing out of six (6) active Funds, the summary of them is below

	Start Date	Raised	Current Est Gross Value
Fund III	January 2018	$1,600,000	$9,500,000
Fund IV	October 2018	$2,200,000	$11,500,000
Fund V	October 2019	$4,200,000	$10,000,000
Sidecar Fund I	January 2021	$7,200,000	$13,000,000
Ground Up Fund	In Process	$10,000,000	$10,000,000
Ironwood Fund	Various (ongoing)	$2,000,000	$ 3,500,000
JVs/TICs	Various	$30,000,000	$65,000,000
	SUBTOTALS	$57,200,000	$122,500,000

*Above figures are estimated dollar amounts based on the Manager's current valuation based on market conditions

So what are the total "admin" costs being paid out of these six (6) active Funds to manage them? Approximately 1/20 of 1% or $60,000. This is for two annual audits (Ironwood and Fund V), tax returns and minor legal costs, etc. If these Funds were being run under a traditional 2/20 fund structure, the annual costs would be well in excess of $2 million. Instead of this capital being sucked annually out of the Funds (negative compounding), it can be reinvested at high rates of return to compound the capital. That is the CAP model.

Deal History (See appendix of this letter for pictures and some sample deals)

For simplicity purposes I have summarized our deal history into three (3) 4-year time frames, which I view as the start-up phase, the team building years and the growth phase. As you can see, the compounding really kicked in during the last 4 years.

	Total Buys	# buildings/Units	Total Sales	# buildings/units
2010 – 2013 Start Up Phase	$6,500,000	8/154	$4,775,000	4/62
2014 – 2017 Team Building	$7,000,000	5/95	$5,000,000	4/53
2018 – 2021 Growth Phase	$171,800,777	24/918	$67,000,000	14/267
Still own (est market value)			$220,000,000	15/785
Subtotal	$181,300,777	37/1167	$296,775,000	37/1167

Compounding

"Take up one idea. Make that one idea your life — think of it, dream of it, live on that idea. Let the brain, muscles, nerves, every part of your body, be full of that idea, and just leave every other idea alone. This is the way to success."

– Swami Vivekananda

Many of you have heard me espouse the benefits of compounding, and I believe they're worth repeating. Compounding is an extremely powerful tool to have in the toolbelt when competing in businesses. CAP is founded on the principles of low fees, alignment of manager and investor interests, and high compounding. When these three things come together; you end up with a very strong system with meaningful competitive advantages. While our competitors are running their own games (high fees, large staff, individual deal focused), we are building and executing a compounding game that over a long period of time makes CAP extremely difficult to compete with due to the capital base becoming larger and larger (which gives us access to discretionary capital and more deal flow being a larger player in the market). **As an example of our compounding, a $100K investment in Fund II in 2012 and rolled into Fund IV in 2018 would be worth approximately $2,100,000, a 21X equity return in ~9 years**. An interesting fact about this result is that one would have to had invested in the S&P 500 in around 1989 and held through 2021, a 32-year period, to have a similar return.

When thinking about compounding, it is helpful to have shortcuts or heuristics to understand the math and how powerful it is. The heuristic we like to use at CAP is the "26% rule". Using the 26% IRR rule, one can see that money doubles every 3 years if you can compound at 26%. If you do this 10 times (10 doubles, 30 years), you can add three (3) zeroes to any number, so $1 million turns into $1 billion. See table below;

$1,000,000 X 1.26 X 1.26 X 1.26 = $2,000,000
$2,000,000 X 1.26 X 1.26 X 1.26 = $4,000,000
$4,000,000 X 1.26 X 1.26 X 1.26 = $8,000,000
$8,000,000 X 1.26 X 1.26 X 1.26 = $16,000,000
$16,000,000 X 1.26 X 1.26 X 1.26 = $32,000,000
$32,000,000 X 1.26 X 1.26 X 1.26 = $64,000,000
$64,000,000 X 1.26 X 1.26 X 1.26 = $128,000,000
$128,000,000 X 1.26 X 1.26 X 1.26 =$256,000,000
$256,000,000 X 1.26 X 1.26 X 1.26 = $512,000,000
$512,000,000 X 1.26 X 1.26 X 1.26 = $1,000,000,000

We take this math very seriously at CAP and aim to try and hit 26% by finding good places to invest capital, keeping expenses low and moving quickly on our real estate deals to drive high IRRs. For reference, all our active Funds (6) have done 26% or more in IRR.

The Future of CAP

Five of our six active Funds are focused on the multi-family rental market in the Southwest. The remaining Fund (Ironwood Fund) is a public equity Fund that only invests in United States equities. The multi-family Funds are currently benefiting from a housing market that has the following interesting dynamics:

1) Younger generations (the millennial and Gen Z generations) are around 50% of the total population now and are more willing to rent than prior generations who focused on buying homes as soon as possible. Note: Millennials are the largest generation in history totaling more than 78 million in the United States, larger than Baby Boomers.
2) The number of one-person households has increased from 7% to 27% in in the last 30 years, creating a demand for more housing
3) The financial crisis of 2008 halted new construction for several years, and while we are now on the backside of this, there is still an extreme housing shortage
4) Housing (purchase) has become unaffordable and out of reach of many
5) Current lending practices are much tighter than in the past and many can't qualify to purchase
6) There is an exodus from high cost, high tax, high density cities to low cost, low tax and lower density cities
7) The work from home trend caused by the COVID pandemic has created a whole new group of people able to relocate and keep their existing jobs with companies based in high-cost cities

TEAM

Lastly, I would be remiss if I didn't mention the people on our team who make all this investment stuff smooth and easy. I am lucky to be surrounded by happy, hard-working, tenacious, and honest people who are passionate about what they do. Penny McAlpin runs our leasing and investor relations teams that are 2nd to none, Geoff Boeyenga runs our construction platform via his company Orange Construction: Geoff creates amazing spaces for our tenants and he never loses his cool, Tracy Bunch, our controller, joined us from DMB this year and she has done an incredible job of taking over all of the complex accounting matters and details (of which there is a lot), Lastly Chad Barber who joined as a partner in our ground up division to secure land and work on zoning matter and construction and budgeting matters, Chad hit the ground running and we have a lot of great projects in the pipeline. Lastly, we also have a great group of interns and other 3rd parties who do so many amazing things for us it would be impossible to mention them all.

Tax & Annual Statement Matters

We strive to get K1s out to our investors as early as possible. Generally, we aim to have K1s out by mid-February, except for the Ironwood Fund which is closer to the beginning of March. Also, we will continue to send out annual statements to investors (which we began in 2021). These statements should be sent out in late January/early February. Except for the Ironwood Fund where the statements are generated by our Administrative firm, NAV. Please note that the statements will come from Tracy Bunch (tracy@capitalallocationpartners.com). These statements reflect estimated current value of your investment. Recognizing that we are investing in a dynamic and fast-moving housing market, we do our best to put a conservative, but realistic value on these assets during our ownership and repositioning.

Call for Action

If you currently have your investments with a high-cost advisor, are looking for new places to allocate money or have a stranded 401K or IRA that you don't know what to do with, I highly recommend thinking about moving it to either the Ironwood Fund or our new Ground Up Fund. We are active managers with an extremely low-cost structure (as outlined above). My personal investment in these funds is large and concentrated, so I care about the results A LOT and therefore my results are your results when you invest in a CAP Fund. The onboarding process is very efficient and streamlined at CAP and our self-directed IRA firm (MIdland) can make the IRA investment process simple for new and/or existing investors.

I will stop there. But again, I want to wish you all a happy healthy, and prosperous New Year. The entire CAP team and I will be working hard to do our part in contributing to the prosperity of those wishes!

Nathan Reid

Nathan Reid
Lead Sherpa

CAPITAL ALLOCATION PARTNERS

Appendix (2021 Annual Letter)

Mariposa on 5th (FUND III) – 511 E. Mariposa, Phoenix, AZ

Purchase Price	$1,700,000	Sales Price	$3,780,000
Purchase Date	7/15/2018	Sales Date	12/15/2020

Sanctuary on Broadway (Fund IV/JV) – 1330 W. Broadway, Tempe AZ

Purchase Price	$42,750,000	Sales Price	$75,000,000
Purchase Date	1/23/2021	Sales Date	3/31/2022

CAPITAL ALLOCATION PARTNERS

Loft on 3rd (Fund III/IV)1401 N. 3rd Street, Phoenix AZ

Purchase Price	$3,350,000	Sales Price	$6,722,000
Purchase Date	7/1/2019	Sales Date	4/2/2021

The James Scottsdale (Sidecar Fund I) 3524 N. Miller Road, Scottsdale, AZ

Purchase Price	$6,725,000	Sales Price	N/A
Purchase Date	4/29/2021	Sales Date	N/A