Fundamental Research Corp.
Investment Analysis for Intelligent Investors

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Capstone Real Estate Corporation – Southwest Opportunity Trust - Greater Phoenix Residential Real Estate

Sector/Industry: Real Estate **www.capstonerealestate.com**

Summary of the Offering	
Issuer	Southwest Opportunity Trust
Offering	Up to $20 million
Securities Offered	Class A Trust Units and Class B Trust Units
Unit Price	$100 per Class A $92 per Class B
Expected Time Horizon	3-7 Years
Expected Returns	8% p.a. preferred return + 40% of the profits after 100% of the capital and preferred returns are received
Management Fee	4% of the gross proceeds upfront / No annual fee / $2,500 on each acquisition /$2,500 on each disposition
Auditors	Collins Barrow

•Based on the Offering Memorandum (OM) dated January 17, 2013.

FRC Rating	
Base-Case Return (IRR)	8.22% p.a.
Rating	**2- (Very Good)**
Risk	3 (Average)

Investment Highlights

- The Southwest Opportunity Trust ("trust") will look to purchase undervalued properties in the southwest United States, with a focus on the Greater Phoenix market.
- The trust is managed by Capstone Real Estate Corporation - a real estate investment company formed in 2004, and based out of Calgary, Alberta.
- Management targets distributions to investors of 8% preferred return per annum. Excess funds over the 8% are re-invested. Upon liquidation, the net proceeds remaining after investors receive 100% of their capital, and preferred returns, will be split 60:40 between management and investors.
- Capstone manages two other funds in the Greater Phoenix area. Independent appraisal reports show significant price appreciation since inception of the funds. Management has local market experience from purchasing over 200 homes for the first two funds.
- Management estimates capital deployment of 60% for buy/renovate/rental, and 40% for buy/renovate/immediate sale.
- Phoenix had one of the highest property price increases in the U.S., compared to other metropolitan cities, in 2012. We expect property prices in Phoenix to continue to increase, though at a much slower rate compared to the rates seen in 2012.

Risks

- No guarantee that investors will receive returns or return of capital.
- Investors have purchased a large portion of homes in Phoenix over the last few years, and could liquidate if there is a shift in market sentiment.
- The trust's business model may not be able to generate a return sufficient to pay 8% annually.
- The time horizon can be longer than the expected 3 – 7 years.
- Our IRR estimate is highly dependent on the returns from flips and the annual turnover.
- Returns are dependent on management's ability to timely deploy capital.
- Exchange rate risks.
- Key person risk.
- The new strategy of immediately selling homes requires more active management than the previous two funds.

PLEASE READ THE IMPORTANT DISCLOSURES AT THE BACK OF THIS REPORT

Background and Terms of the Offering

Capstone Real Estate Corporation ("company") was formed in 2004. Until 2010, they were involved in real estate investment and development in Calgary and Edmonton, Alberta. Since early 2010, Capstone has offered real estate investment opportunities through two funds – Saguaro Capital Fund 1 and Saguaro Capital Fund 2. Through the two funds, Capstone has purchased over 200 homes in the Greater Phoenix area.

The Southwest Opportunity Trust was setup to acquire undervalued residential properties in the southwest United States, focusing on the Greater Phoenix area. They plan to renovate the homes to increase value and then rent or immediately sell ("flipped") them to provide returns to investors. Investors will be eligible for a preferred return of 8% per annum. Upon liquidation, the net proceeds remaining after investors receive 100% of their capital, and preferred returns, will be split 60% (management) and 40% (investors).

Since its inception in 2004, Capstone has built a track record of two land development offerings in Alberta, two Phoenix real estate offerings, and five condo conversions. Highlights of the past offerings provided by management follow.

1. The company's first limited partnership ("LP") offering was Heritage Valley LP. The project included 73 acres of raw farmland in Edmonton. The LP, established in 2004, raised $2.5 million. The land was sold in 2006, with 100% of the funds distributed back to investors by December 2008. According to management, investors received an overall return of 130% from that investment. We have not verified this information.
2. The second LP, established in 2007, was the Shepard LP. The project includes 100 acres of land located in the Shepard Industrial Corridor, located 0.25 miles from Calgary city limits. The LP raised $4.5 million from investors. The acquisition price was $75,000 per acre. The property has not yet been sold.
3. Saguaro Series 1 was the first of the two Phoenix real estate funds. This offering raised $8.28 million (initial plans were to raise up $10 million). This was Capstone's largest offering until Saguaro Series 2 (capital raised – $18 million, initial plans - $20 million) was formed. **We have conducted due diligence on the Saguaro Series 2 fund in a report dated July 22, 2011, where we provided a rating of "3 – Good" on the fund.**

A brief description of the company's five condo conversions (provided by the company) follow. All the projects listed below were owned by Capstone's President, Jim Vincent.

1. The DEKS on 6th - *34 hi-rise condo units in downtown Edmonton.*

2. Palisade Garden Terrace - *in the neighborhood of Queen Mary Park - both one and three bedroom condo units were offered to investors - all units were offered at less than $100,000 and have experienced significant appreciation.*

3. Parkside Village - *located in downtown Edmonton - 40 one, two and three bedroom condo units were offered to investors for $99,000-$135,000 – the units were completely sold out in a few weeks.*

4. Wild Rose Court - *one & two bedroom condominiums near Queen Mary Park in Edmonton - all units were offered at less than $100,000 and have experienced significant appreciation.*

5. Flagstone - *located in Queen Mary Park - 44 condominiums - these properties generated significant returns in a short period of time.*

Source: Company

Why Invest in Real Estate?

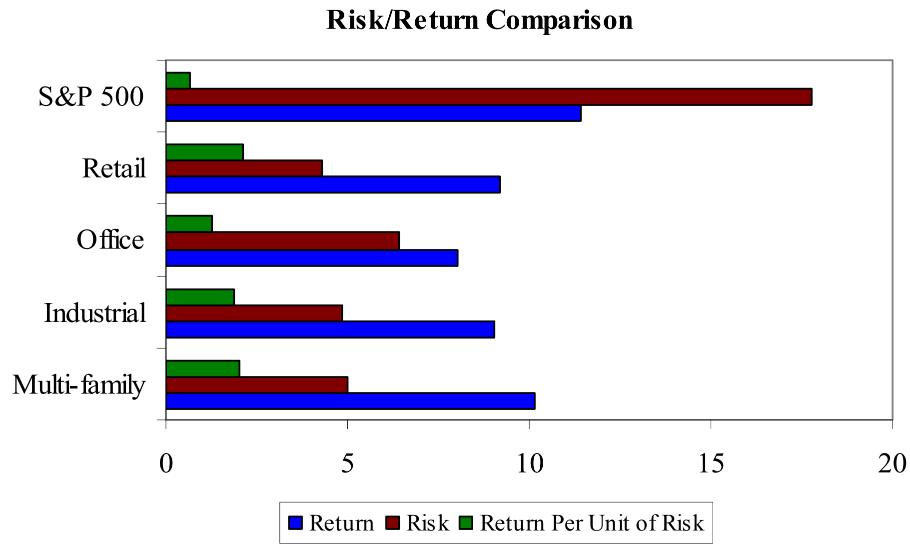
The following factors demonstrate the benefits of adding real-estate investments to an investment portfolio:

Diversification: Real estate offers significant diversification benefits to an investment portfolio. A look at US stocks/bonds and real estate investments over the period of 2001-2010, illustrates the potential diversification benefits. **Over this period, the S&P 500 had a correlation with the NCREIF NPI index (private real estate) of 0.23.** The NAREIT Equity index, a broad index of publicly traded REITS (Real Estate Investment Trusts), had a correlation with the S&P 500 of 0.71. The lower the correlation, the higher the diversification benefits – implying that private real estate investments have historically been better for diversification compared to publicly traded REITS.

	NCREIF NPI	NAREIT Equity Index	S&P 500	Russell 2000	Barclays Agg Bond Index	Morgan Stanley EAFE Int'l Stock
NCREIF NPI	1					
NAREIT Equity Index	0.29	1				
S&P 500	0.23	0.71	1			
Russell 2000	0.21	0.77	0.94	1		
Barclays Agg Bond Index	-0.17	-0.02	-0.36	-0.39	1	
Morgan Stanley EAFE Int'l Stock	0.21	0.69	0.92	0.86	-0.24	1

Sources: NCREIF, NAREIT, S&P, Russell, Barclays Capital, and MSCI. Clarion Partners Research & Investment Strategy. Note: correlation coefficient among quarterly returns.

High risk-adjusted returns: Below is a chart illustrating the risk adjusted returns on different real estate options over a large (Q1-1978:Q1-2010) and, relatively, up to date interval. Over the period, the S&P 500 generated an average return of 11.4%, standard deviation of 17.8%, and a return per unit of risk of 0.64; which is far below the risk adjusted return of real estate investments.



Source: NCREIF, LaSalle Investment Management, August 2009, Marquette Associates Oct 2010

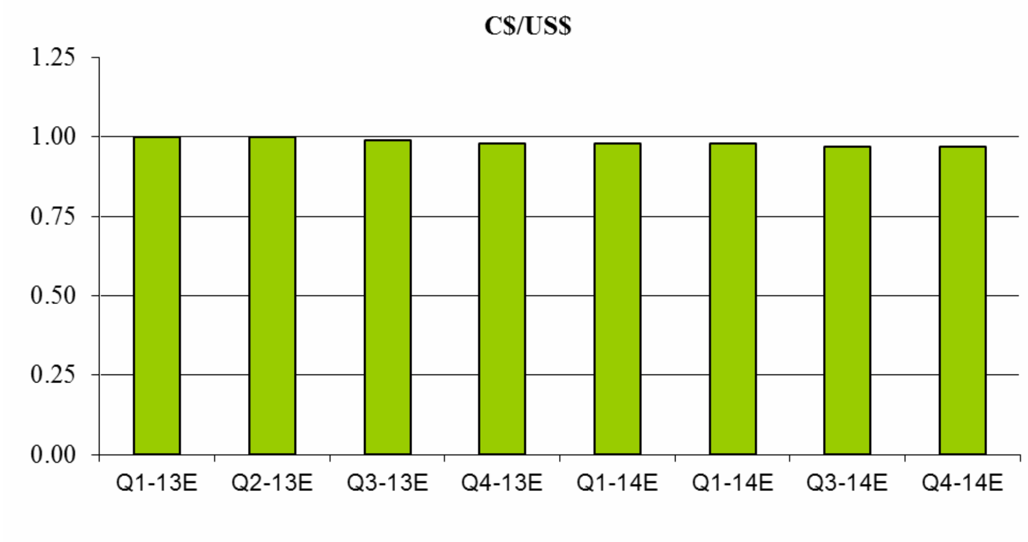
Inflation hedging: Real estate investments typically provide a good hedge to inflation as rental rates can be increased with inflation.

Tax benefits: Real estate investments may offer tax deductions, through property depreciation, potentially offsetting the tax implications of the income received.

Leverage: Real estate investments typically offer high leverage potential whereby a property can be purchased or built with a cash outlay much less than the value. The benefit of leverage to investors is the magnification of returns (including losses). Most investments do not offer the ability to leverage as much, or as easily, as real estate investments. The relatively low interest rate environment at this time is beneficial as it could result in higher returns for real estate investors. **Capstone is unlikely to use debt for their acquisitions, so this feature is not likely to apply to investors of this offering**.

Cash flow and price appreciation: Following the recession in the U.S., several home owners ended up with negative equity in their homes and defaulted on their mortgages. This increased the amount of renters. **The low property prices, and the high rental demand, especially in select regions in the U.S., we believe, offers investors the opportunity to purchase properties at cheap valuations and receive strong cash flows from rent.** This is exactly what Capstone has been capitalizing on since their entry in Phoenix in 2010.

Favourable exchange rates: Real-estate investments in the U.S. are more attractive for Canadians when the C$ (with respect to the US$) is strong at the time of investment (which makes acquisitions cheaper in US$), and weak at the time when the assets are sold (which implies higher returns in C$ dollars). **The following chart indicates that the US$ is expected to stay near par over the acquisition period - which will significantly benefit Capstone on their acquisitions.** With a gradual recovery in the US economy, we expect the US$ to recover in the long-term – which will be beneficial for Capstone when the properties are sold. **The exposure to the US$ is an added risk, but we think it will benefit investors.**



Source: TD Economics

Management

Brief biographies of the management team, as per the OM, follows:

Jim Vincent, B.Sc. – President and Director
Mr. Vincent has a Bachelor of Science Degree from the University of Guelph and holds a Management Diploma from the University of Michigan. Jim Vincent has over 25 years of experience in the real estate investment and development field. Mr. Vincent currently owns/manages several privately-held real estate corporations specializing in the areas of single and multi-family revenue properties, luxury international recreational properties and land development.

Amber Point Caribbean, established in 2006, is a personal portfolio of Jim Vincent's along the Amber Coast of the Dominican Republic. It consists of large vacation villas, luxury ocean front condominiums and developed beach-front resort land. Mr. Vincent has extensive experience working internationally with lawyers, governments, banks, currency brokers, developers and real estate professionals. Mr. Vincent is the Founder, President and Chief Acquisition Officer of Capstone Real Estate Corporation. Mr. Vincent is responsible for all activities relating to the evaluation, acquisition and management of properties for Capstone and its affiliates.

David Udy, CFP, TEP - Vice President and Director
Mr. Udy holds the designations of Certified Financial Planner and Trust and Estate Practitioner. David Udy has over 20 years' experience in the financial services industry along with extensive experience in real estate marketing and development. Mr. Udy is the Founder and President of WealthCo Financial Advisory Services which was established in 1999. WealthCo specializes in investment, insurance and tax planning strategies for business owners and high net worth individuals.

Prior to establishing WealthCo, Mr. Udy held the position of Canadian Vice President of

Sales for IOF Foresters. Headquartered in Toronto, Canada IOF has over 650,000 clients and over $6 billion in assets. Mr. Udy oversaw sales operations, product development and distribution for Canada. Mr. Udy has acted in the capacity of General Partner for Capstone at Shepard Limited Partnership and 543 High River Limited Partnership (this project is outside of Capstone – it was a $2.4 million land acquisition offered through WealthCo) both of which have focused on land acquisitions in the Calgary and High River Alberta areas. Mr. Udy is also the Vice-President, Corporate Secretary and Director of Saguaro Capital Fund Series 1 Inc. and is the President and Director of Saguaro Capital Fund Series 2 Inc**.**

Management based in Calgary

Capstone's headquarters are in Calgary, Alberta, and they do not have any permanent employees in the Phoenix area. **According to management, Jim Vincent has a residence in Phoenix, and coordinates all the purchasing, renovations, rentals and sales.** For their Phoenix operations, Capstone hires people on a contract basis. They feel this allows them flexibility to manage/control their expenses. Capstone retains an unrelated property management firm, Valentine Sales & Management ("VSM") in Phoenix to assist Mr. Vincent. Capstone previously used multiple property management companies, but shifted all its business to VSM because it, according to management, offers the best service. Management also feels that VSM's focus on residential homes, and ability to rent out properties relatively quick, are positive for Capstone's business model.

We have spoken with Dan Valentine, owner of VSM, about his company and their role with Capstone. The following is from our discussion with Mr. Valentine:

VSM is a full service property management and sales company that currently employs 25 staff members in their Phoenix office. They specialize in property management and sales of residential single family homes in Greater Phoenix. VSM currently manages over 500 residential homes. Mr. Valentine has been a real estate agent for 36 years and has worked in the Phoenix market for 32 years.

VSM assists Capstone throughout the whole process – from acquisition to sale.

Acquisition - VSM aids in searching and finding properties for Mr. Vincent to review.
Renovations - VSM will manage and supervise the renovations of acquired properties once Mr. Vincent has approved the renovations.
Renting - Once a property has been renovated, VSM will interview and find renters for each property and handle the management of the property. The details on homes are input into an online property management software by VSM staff. This allows management in Calgary to access and analyze property data quickly and efficiently.
Selling – VSM manages the sale of the homes under the direction of Mr. Vincent.

VSM collects fees depending on the work performed – typically 11% of the rental income from the managed properties, and a commission of 5% from the sale of properties.

Generally, we would view a lack of permanent staff in Phoenix as a major risk to investors. However, Capstone has shown through previous funds that it has built relations and infrastructure that it can rely upon to manage all the assets. We believe key person risk exists as the trust relies heavily on Jim Vincent's expertise.

History and Performance of Saguaro 1 and 2

In the following section, we review the performance of Capstone's first two Phoenix based funds.

Saguaro 1 was launched in December 2009, and financing was closed in September 2010. The Saguaro 2 fund was launched in December 2010; its funding was closed in June 2012. Through these two funds, Capstone has purchased over 200 properties in the Greater Phoenix area (Source: an independent appraisal report). These two funds utilize a buy/ renovate/ rent strategy with a time horizon of 3-7 years. A brief description of the holdings of the funds follows.

The Saguaro 1 fund purchased 78 homes with an average price after renovations and fees (all-in price) of $89,500. The average rent for the properties in the fund is $1,005 a month. **Since purchasing these properties, the estimated market value has risen approximately 47%.** For the Saguaro 2 fund, management purchased 129 properties at an average all-in price of $105,100, and they are renting at an average rate of $1,047 per month. Properties in the **Saguaro 2 fund have risen approximately 33% since their purchase.** Management provided these fund summaries. We feel that the price appreciation rates are accurate after reviewing the fund's financial statements, and an independent appraisal report (dated February 2013) on the market values of all the properties held by both funds. The performance of the prior funds indicates management has the ability to identify properties with both cash flow and price appreciation opportunity.

According to management, **the current average gross rental yield (rent as a percentage of home price) for fund 1 is 13.5%, and for fund is 12.0%**. From the audited financial statements for fund 1, we verified that the gross rental yield was 13.21%, and net rental yield was 7.5% in 2011. The net income was just enough to meet the 6% interest on the bonds – note that the interest was not paid out as it is not due until maturity. The 2012 financial statements are yet to be completed. We cannot comment on fund 2's performance as the fund completed its acquisitions in 2012, and its 2012 financials are yet to be completed.

We have spoken to Dan Valentine who organized the recent independent appraisal of the properties (mentioned above). To value the properties, the valuator used standard real estate industry valuation techniques. The homes were compared to active listings, pending sales, and sold listings in the local neighborhood. In addition, the evaluator looked at type of sale, condition, and time on market. The evaluator used comparable properties and their experience to estimate the value of each home. The homes were not visited and inspected because they were all purchased within the last 2 years.

Interest payments by the two funds: Both funds offered bonds to investors. **Saguaro fund 1 offered bonds at a rate of 6% p.a.** The bonds and accrued interest are payable on January 1, 2015. **The bonds issued by fund 2 pay 6% p.a. and are paid semi-annually.**

We have reviewed the audited financial statements for the two previous funds. For the

Saguaro 1 fund, we are unable to comment on the payment of interest because payment is not due until January 1, 2015.

For fund 2, the 2011 audited statements do not show any interest paid because interest was not yet due. The 2012 statements have not been completed. Management has provided an internal payment schedule showing that all payments have been paid.

Capstone Acquisition Strategy

For the current offering, management will not issue bonds; instead, it will issue trust units, which are eligible for a 8% preferred return. **Unlike the bonds, management is not required to pay out the 8% preferred return, which we feel increases the risk of not receiving an annual return for investors.**

Capstone has displayed their ability to identify and purchase homes at below market value in the prior funds. For the prior funds, the company's major buying avenues were trustee auction sales (public auction of foreclosed assets) and REOs (real estate owned by lenders). The sellers of distressed properties, which are typically lenders, are more willing to sell at a discount because: 1) it allows them to get rid of those assets from their books as holding real estate assets is not their primary business, and 2) it gives them an opportunity to monetize those assets immediately.

The typical auction for distressed properties consists of the following: Auctions are held daily and the trustees typically provide a list at 2 pm on the day prior to the auction. Capstone will analyze the list and shortlist assets based on the following criteria.

- Attractive single family home in a nice community
- Easy freeway access
- 3 bed, 2 bath or bigger
- Double garage, air conditioning, etc.
- Concrete fence
- Low maintenance landscaping
- $50K - $150K price range for rental.
- $200K – 350K price range for flips.

After shortlisting properties, contract workers ("runners") are sent to view and inspect each individual property. The runner takes pictures of the property and reports to Mr. Vincent on the condition and location of the property. The site visits are very crucial for two reasons, as they allow management to identify: 1) better quality homes - as they can generate higher rent and/or sale price, and 2) properties with low renovation costs to bring to a saleable condition. Capstone's average renovation cost per home has been $5,500 for the first two funds.

If the property is won at auction, a $10,000 cheque is immediately due. Capstone has 24 hours to do their due diligence on the property after which they must pay the balance in cash. **By requiring buyers to pay in cash within 24 hours, it limits a large portion of the general public from purchasing, and allows buyers to get a discount from market**

value. Jim Vincent is not physically present at each auction. After reviewing the information from the runners, he will set a maximum price for each property and bidders will bid for him.

According to management, their due diligence process includes - "*Confirm titles, liens, home owner association fees, comparative data, physically inspect those homes that meet criteria etc.*" **Management believes that Capstone's due diligence process, especially the physical inspection of homes before their acquisition, is one of the primary reasons why they have been able to acquire quality homes below market value.**

Opportunistic Buying

Upon acquiring these assets, the company would then complete renovations (if required) and hire their property management company (VSM) to find tenants and manage the assets. Capstone works with five contracting companies for renovations and will usually get 2-3 quotes per renovation. Capstone uses standard carpet, paint and other building materials to ensure consistency and speed for the renovation. Renovations are typically completed in 3 weeks. For Series 1 and Series 2, management estimates that over 90% of the homes they have acquired were vacant at the time of purchase**. Management says that their average time from acquisition to rental is 42 days.**

Strategy 1 - Buy/Renovate/ Rent

Over the last two years, the market for distressed properties has become more competitive and the number of distressed properties has decreased, as we will discuss later. By having been in the Phoenix real estate market for the last few years, Capstone have built relationships with lending institutions that allows them to buy in bulk or through non-public channels. This avoids prices being bid up at a public auction. Management will purchase homes from any source (MLS, Auctions, Banks, and Lenders) as long as the price offers a discount to their determination of market value.

Capstone will utilize the same acquisition and renovation strategy of the previous funds, as discussed earlier**.** For the Buy / Renovate / Rent strategy, Capstone will look to rent a property for 1-7 years before exit. **Capstone intends to purchase homes with a gross rental rate of at least 12% p.a. on the all-in acquisition price.** For example, a $100,000 home would have to return $12,000 annually, or $1,000 a month, in order to generate a gross rate of 12% p.a. **The Capstone team targets a net rental yield (gross rental income minus expenses) of 7.5% p.a.** Properties for rentals will be purchased in the first year upon receiving investor funds. We feel that there are still opportunities to find properties generating 12-13% p.a. gross rental income. We have looked at various housing market data and specific listings to arrive at this opinion.

Choosing the right tenant is crucial for this business model. **To mitigate this risk, Capstone uses VSM to screen and manage the renters. The current vacancy rate across all homes in the existing funds is around 6%.** Note that the U.S. rental market (compared to Canada) has fewer rent controls and laws preventing the eviction of tenants - this is beneficial for Capstone as evicting tenants defaulting on payments is relatively easier in the U.S.

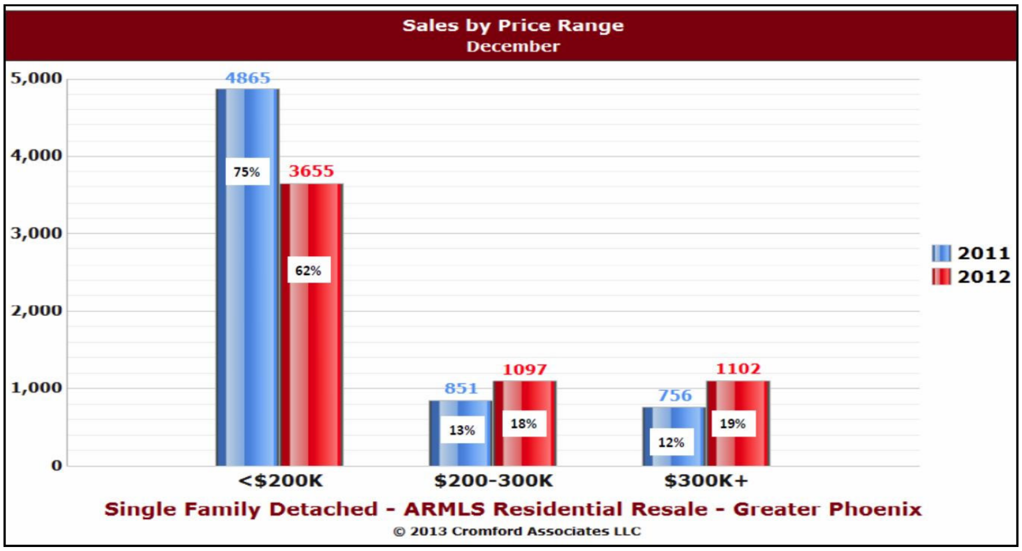
Cost breakdown: Our base-case estimate of net rental yield of 6.8% is lower than management's target of 7.5% because we used a higher vacancy rate and maintenance/repairs/miscellaneous expenses. The following shows the expected breakdown of the acquisition cost of an average house, expenses related to rental, and the net income the house can potentially generate.

Model Buy - Rent	
Cash expected to be available for Rental (60% of the maximum offering)	$9,929,000
Average Cost Per Home	$ 125,000
Acquisition fee	$ 2,500
Rehab-10%	$ 12,500
Holding (HOA, insurance etc.) -2%	$ 2,500
Misc.- 1.5%	$ 1,875
Average Cost Per Home	$ 144,375
Total Number of Homes Purchased	69
Rental Income	
Gross Rents= 12%	$ 17,325
Less : Vacancy= 6%	$ 1,040
Rental Income	$ 16,286
Expenses	
Real Estate Taxes	11.20%
Property Insurance	3.20%
Utilities	1.50%
Pool Services	0.80%
Maint/Repairs/Misc.	2.50%
HOA Fees	2.20%
Misc./Legal	1.00%
Leasing/Advertising	4.20%
Management Fee	10.90%
Total expenses	37.50%
Rental Exp -37.5% of Rent	$6,497
Net Rental Income	$9,789
Net Rental Yield	6.78%

Source: Company and FRC

Strategy 2 - Buy/Renovate/ Sell

In addition to renting properties, management will look to immediately sell ("flip") a portion of the properties after they have been renovated. Management explained that this new exit strategy is to offer them more flexibility in the type of property they can acquire, and more versatility in exiting projects. Low cost properties often return a higher percent of rental yields than higher priced properties. The majority of current demand from investors is for the lower priced high rental yield properties; as shown in the chart below.



Source: Cromford Associates

The above chart also shows that the amount of activity in low-priced homes is decreasing, while activity in the mid and high priced sector is increasing.

Through their experience in the Phoenix market, management feels they have identified an opportunity to purchase higher priced homes at a discount, that would not generate the rental yield (12% or higher) they are looking for, but could be sold quickly at a profit. Management will look for homes in the $200,000-$350,000 range for this strategy. Management estimates 60% of the properties would be held for rental, while 40% would be purchased with the intention to sell after renovations. This is an estimate from management and there is nothing in the OM that restricts their ratio of exit strategy.

Investors have driven up the prices of lower cost housing in 2012, as shown by the table below.

YOY Increase in Price per SF - December 2012	
Less than 100K	54.0%
100K-150K	51.3%
150K-200K	36.3%
200K-300K	29.2%
300K-400K	23.7%

Source: ARMLS

The key factors to assess when looking at the total annual return from the flips are the returns per flip and the annual turnover. Management is targeting a 10% net return on each flip. To achieve this, the property will need to be sold for 17% more than the all-in purchase price.

The following table shows that the all-in purchase price of a $250,000 home will be approximately $286,250.

Model - Buy/ Reno/ Sell	
Expected funds available (40% of the maximum offering)	$6,619,334
Properties Purchased	
Purchase price	$250,000
Acquisition fee	$2,500
Rehab- 10%	$25,000
Holding - 2%	$5,000
Misc.- 1.5%	$3,750
All in cost	$286,250
Total Number of Homes Purchased	23

As mentioned above, in order to achieve a 10% net return for a flip, the sale price of the property should be 17% higher than the all-in purchase price. The following table shows the net returns at various sales prices.

Property price increase from all-in costs	0%	5%	10%	15%	17%
Sale price	$ 286,250	$ 300,563	$314,875	$329,188	$334,913
Sales Commission (5%)	$ (14,313)	$ (15,028)	$ (15,744)	$ (16,459)	$ (16,746)
Management fee for disposition	$ (2,500)	$ (2,500)	$ (2,500)	$ (2,500)	$ (2,500)
	$ 269,438	$ 283,034	$296,631	$310,228	$315,667
Net Profit	-$16,813	-$3,216	$10,381	$23,978	$29,417
% Net return (net profit / all-in costs)	*-5.87%*	*-1.12%*	*3.63%*	*8.38%*	*10.28%*

The higher the turnover of property flips, the higher the returns from the capital deployed on flips. Based on prior experience, management feels that after acquiring the property they can have it renovated and ready for sale in approximately 45 days. The average days on market ("DOM") in greater Phoenix was 73 days as of January 2013 (Source: ARMLS). **This would result in a total average acquisition to sale of around 120 days – which is in-line with management's target of 3 flips a year.**

The following is an example of a quick sale by Capstone in Phoenix. It was the only sale from the prior two Saguaro funds. The house (image below) was purchased for an all-in price of $105,000, including $10,000 in renovations. The house was rented out for 1 year; it was then listed on the market for $150,000. The house generated multiple offers and was sold for $165,000.

Source: Capstone

Management has flexibility in choosing their target flip return because they can rent the property and sell at a later date. After a flip, management intends to re-deploy the capital for rent or flip, depending on market conditions.

Example of Renovations

The following group of pictures is not from the above sold home. They are a sampling of the renovations done on the previous fund properties. From the pictures, we can see the average renovation cost of $5,500 can quite significantly update and improve a home. Management states that the majority of work they do is cleaning the property adequately, as distressed homes are often left in poor condition. Paint and other standard cosmetic changes can also increase valuations.

Before and after pictures of previous properties (provided by management)

Source: Capstone

In the following section, we review the key macroeconomic factors affecting housing prices in Phoenix – which includes, GDP, employment, population and affordability.

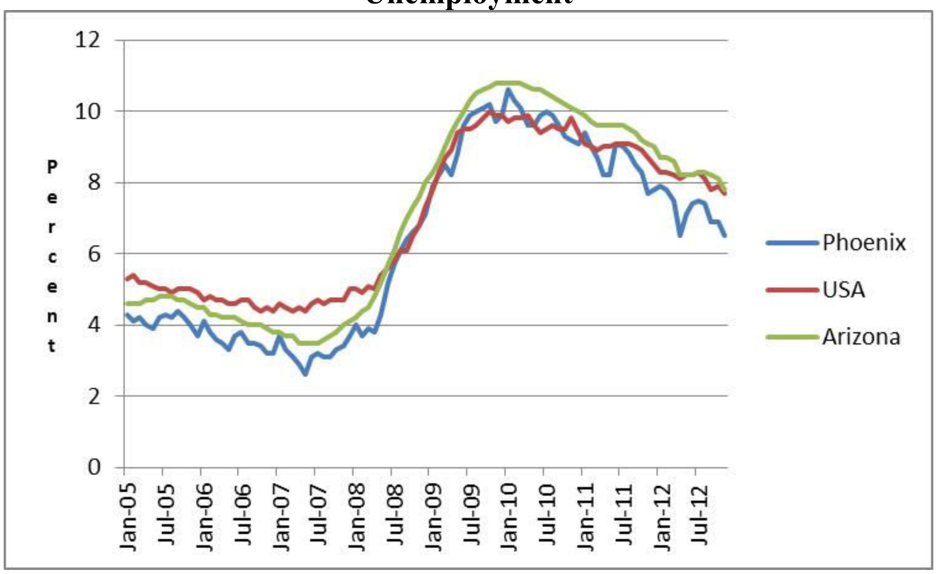
Gross Domestic Product (GDP)

Since 2004, Arizona's GDP growth rate has been superior to that of the United States. However, following the recession, the state's GDP decline was greater than that of the nation. This is mostly attributable to the deep decline in the housing industry in the state. Greater Phoenix accounts for approximately 75% of the state GDP. Since the lows of 2009, Arizona has been recovering slowly. The forecasted rates of growth for Phoenix are 5.7% for 2013, and rising to 6.4% for 2014 (Source: WP Carey Consensus -"Consensus") – substantially higher than the national average. We anticipate Phoenix's economy to show strong growth over the medium term (5 years). From the data discussed later, we will see that the housing market is leading this growth in GDP.

Unemployment

The unemployment rate in Arizona has steadily decreased since reaching a post-recession high of 10.8% in November 2009. The greater Phoenix area has historically had a lower unemployment rate than Arizona, as shown in the chart below, due to Phoenix being the state's major employment and commerce center.

Unemployment



Source: U.S. Bureau of Labor Statistics

Employment growth has been on the rise with Phoenix posting 2.96% YOY growth in employment as of December 2012. This was the second highest growth rate in the U.S. of metropolitan areas over 1 million people. The job market has rebounded from the lows in 2009, and is anticipated to be strong. For Phoenix, in 2013, the consensus expected growth in employment is 2.7%, followed by 3.1% in 2014. Arizona State University (ASU) expects employment to grow at 3% in 2015, and 4% in 2016.

Population

For the period from 2000 to 2010, the Greater Phoenix population increased by 28.9% in comparison to the United States' 9.8%. The consensus rate of growth in Greater Phoenix is estimated at 1.7% for 2013, and 1.9% for 2014. **The population of Greater Phoenix is forecasted to almost double by 2030, according to the Greater Phoenix Economic Council.** The strong population increase in the future is expected to drive demand for housing. The below table displays the population growth forecasted for the communities that make up Greater Phoenix.

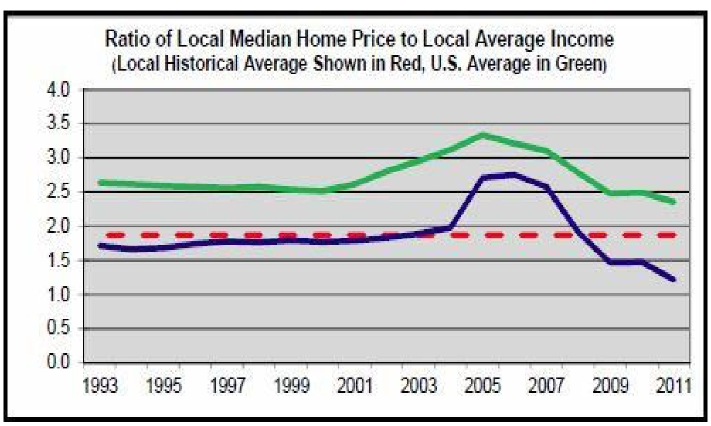
COMMUNITY	2000	2010	2030	2000-2010 % CHANGE	2007-2030 % CHANGE	2000-2030 % CHANGE
Apache Junction	31,814	35,840	41,751	13	10	31
Avondale	35,883	76,238	123,265	112	61	244
Buckeye	8,497	50,876	419,146	499	736	4,833
Casa Grande	25,224	43,644	114,613	93	180	354
Chandler	176,581	236,123	283,792	34	16	61
Fountain Hills	20,235	22,489	33,810	11	30	67
Gilbert	109,697	208,453	300,295	90	40	174
Glendale	218,812	226,721	322,062	4	30	47
Goodyear	18,911	65,275	299,397	245	404	1,483
Maricopa*	1,482	43,482	363,967	2,834	877	24,459
Mesa	396,375	439,041	584866	11	28	48
Peoria	108,364	154,065	306,070	42	97	182
Phoenix	1,321,045	1,445,632	2,201,843	9	41	67
Queen Creek	4,316	26,361	72,947	511	206	1,590
Scottsdale	202,705	217,385	286,020	7	18	41
Surprise	30,848	117,517	401,458	281	269	1,201
Tempe	158,625	161,719	197,970	2	15	25
Tolleson	4,974	6,545	10,193	32	48	105
Wickenburg	5,082	6,363	17,732	25	175	249
TOTAL POPULATION	2,879,470	3,588,769	6,381,197			

* Calculated based on 2025 estimate from City of Maricopa

Source: Greater Phoenix Economic Council

Affordability

In 2011, affordability was the best it has been in the Phoenix market in over 15 years. The lower cost of houses, and the low interest rates, have made purchasing a home very affordable. The Phoenix market's affordability is also considerably better than the national rate (see chart below). Affordability is a good indication that the housing market has room for price appreciation. **As rents continue to increase, and the rental market becomes more competitive, we expect home ownership will become more attractive.** The below graph displays median home price as a percentage of the average income in the Phoenix area (Blue).

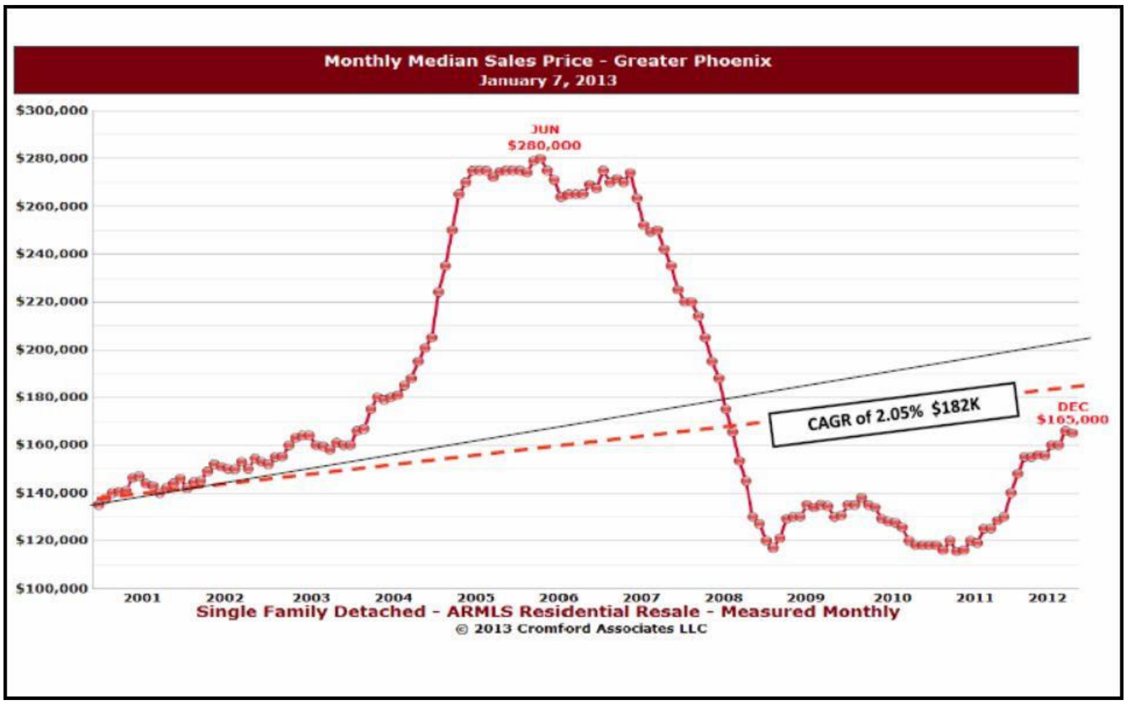


Source: National Association of Realtors

Following the recession, the Federal Reserve lowered the bank rate to increase lending and borrowing. This resulted in historically low interest rates for mortgages and financing. **The Federal Reserve has indicated that it intends to keep the target range for the federal funds rate at 0 to 0.25%, until the unemployment rate decreases to 6.5%.** At the current pace of employment growth, the Federal Reserve predicts that this will take until late 2015. The low interest rates will increase demand and be beneficial to the Phoenix housing market.

Housing Prices

The Greater Phoenix area housing market was one of the worst performing housing markets in the United States, following the housing collapse. From a peak in June 2006, to a low in April 2009, median home prices in the area declined by over 54% (Source: Case-Shiller) Since early 2011, the housing market in Greater Phoenix registered one of the highest price appreciation rates in the country. **As of December 2012, Greater Phoenix showed a median price of $165,000, up 34% YOY (Source: ARMLS).** The following chart shows the median sales price in Greater Phoenix since 2001.



Source: Cromford

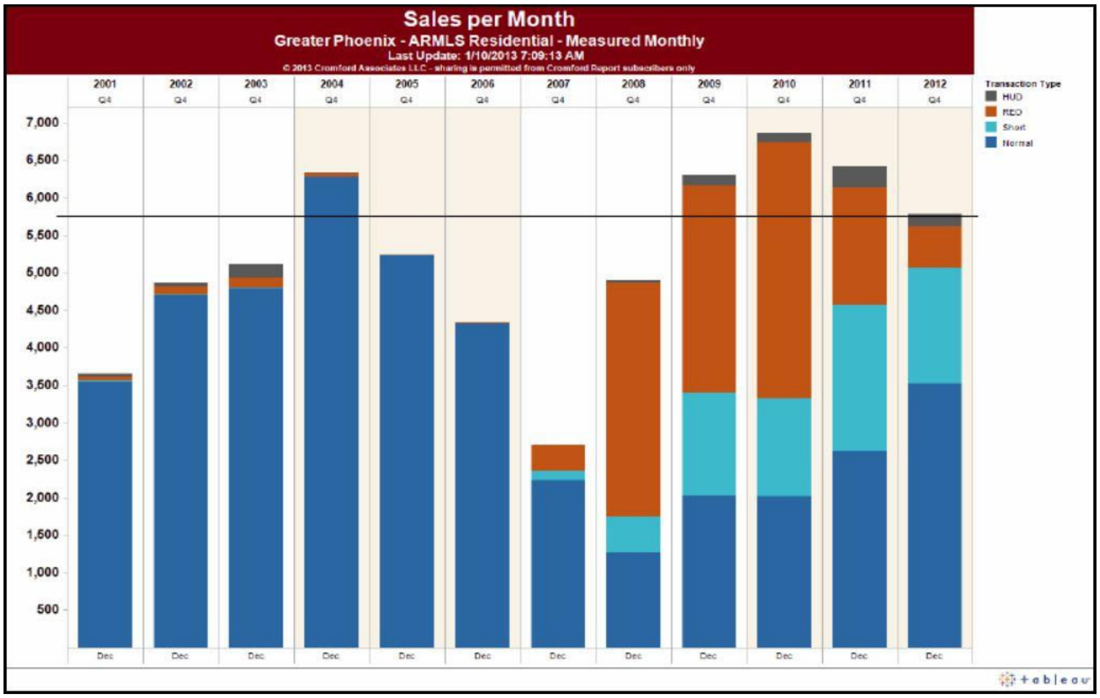
Investors Presence in Phoenix

One of the major causes of the significant price appreciation in 2012 was increasing numbers of investors bidding on a decreasing supply, as shown in the chart below.

Source: ARMLS

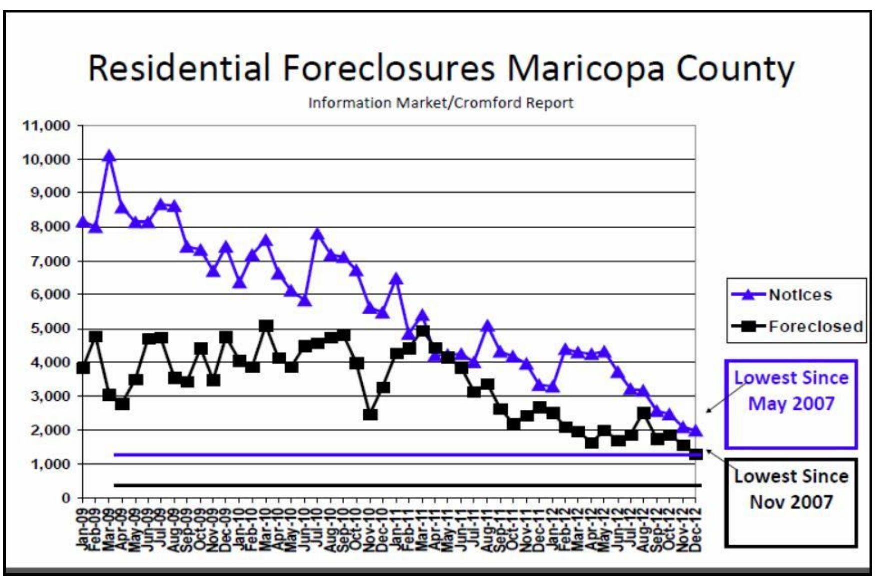
When purchasing a home in Phoenix, purchasers are required to indicate who will occupy the house. This has made tracking investor owned properties easier and more accurate. **Investor purchases accounted for approximately 33% of home purchases in December 2012.** This level is down from the July 2012 high of around 39.7% (Source: ARMLS). We anticipate that there will continue to be a strong investor presence in Phoenix, but the level will decrease as prices rise and capitalization rates on homes decrease.

As shown in the above chart, Greater Phoenix had the lowest amount of new listings in the last 10 years. A major cause of the decrease in new listings is the decrease in the number of distressed properties. When Capstone acquired properties for their first fund in 2010, 70% of the total acquisitions were distressed; this figure dropped to 58% by the end of 2011, and to 39% in 2012. In December 2012, the amount of short sales (properties sold at prices below what is owed to lenders) decreased by 36% YOY. GSE, which are government owned properties, declined by 70%. Bank owned sales or REOs were down by 55%. The following charts display the various types of distressed property sales as a percent of total sales. The dark blue is normal sales, orange is REOs, turquoise is short sales, and grey is HUD (government) sales.



Source: ARMLS

The amount of foreclosures in Greater Phoenix was one of the highest in the country, but as seen in the chart below, has been decreasing since 2009. In the first 6 months of 2012, delinquencies and foreclosures declined and were at their lowest rates since 2007. **The average foreclosure discount from the market price was 24% in Q4-2012 (Source: RealtyTrac).** We expect the distressed property discounts to continue to decline as the supply of distressed properties decreases.



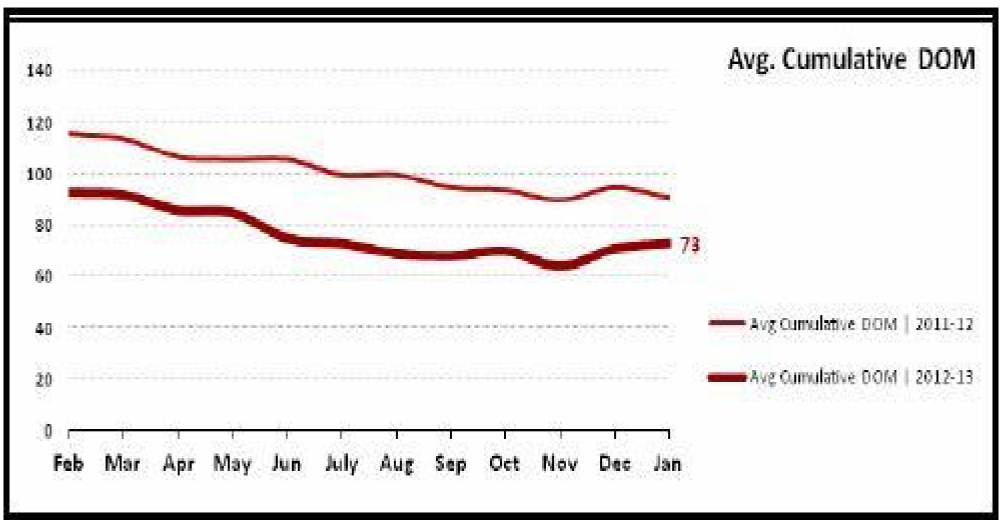
* Phoenix is located in Maricopa County
Source: Cromford

The decrease in supply of existing home sales is expected to be offset by an expected increase in new construction. The construction industry is expected to see the highest employment growth compared to other industries over the next few years. Building permits are expected to show significant increases over the next 5 years as forecasted by the ASU.

	2012	2013	2014	2015	2016	2017
Residential permits (units)	15,501	18,198	23,790	32,870	40,866	45,536
% Change YOY	70.70%	17.40%	30.73%	38.17%	24.33%	11.43%

Source: Arizona State University

The average days on market ("DOM") has been decreasing since early 2011 (as shown in the chart below) – which indicates strong demand and drop in supply. The DOM is critical to Capstone's flip strategy, as higher turnovers can potentially lead to higher total returns.



Source: ARMLS

Over the short-term that Capstone is seeking to acquire properties, we anticipate there will be sufficient opportunity to purchase properties at a discount. We feel that over the long run, as the market returns to normal, distressed properties will not offer the discounts seen now. This will be a significant challenge for Capstone in the longer term when flipping homes.

Rental Market

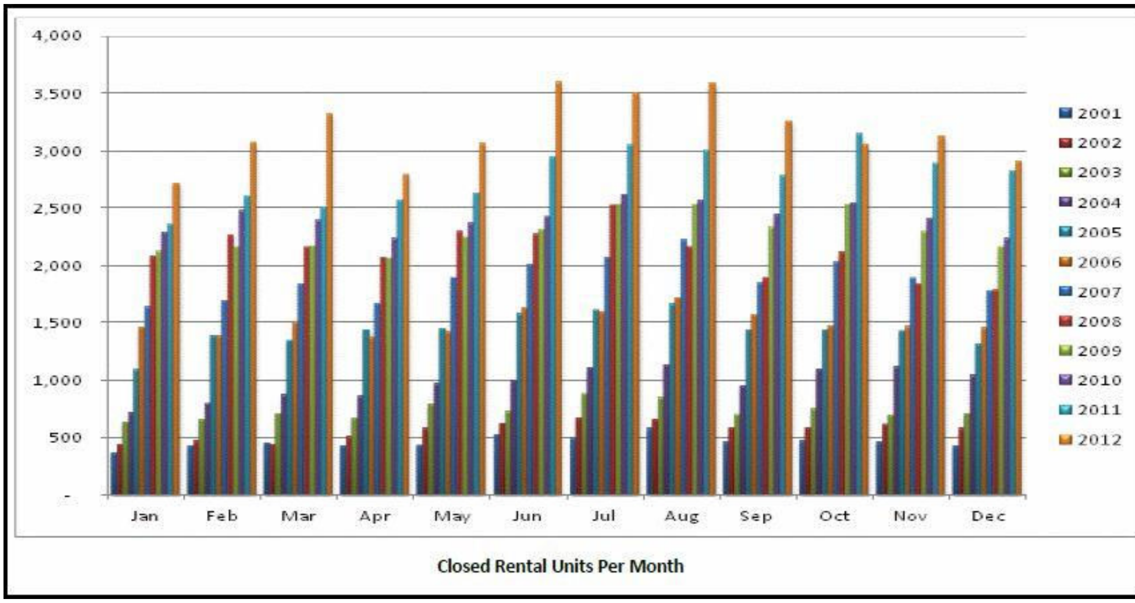
We will now look at the rental market to see if there is adequate demand and opportunity for Capstone to rent out the acquired properties.

The rental market in the Phoenix area has been increasing steadily since 2001. The following reasons have been driving Phoenix's rental demand:

1. Those that lost their homes and have poor credit cannot finance a property.
2. Increasing population
3. People looking to purchase homes are being out bid by well-capitalized investors.

4. The traditional market of renters who cannot afford to own.
5. People scared by market downturn prefer to rent rather than risk ownership.

The rate of home ownership has declined from 70%+ in 2004/2005 to approximately 50% in 2009/2010 in Phoenix (consensus estimates) – a factor that indicates strong growth in rental demand. As the following chart shows, the number of new rental contracts has been consistently rising each month since 2001.



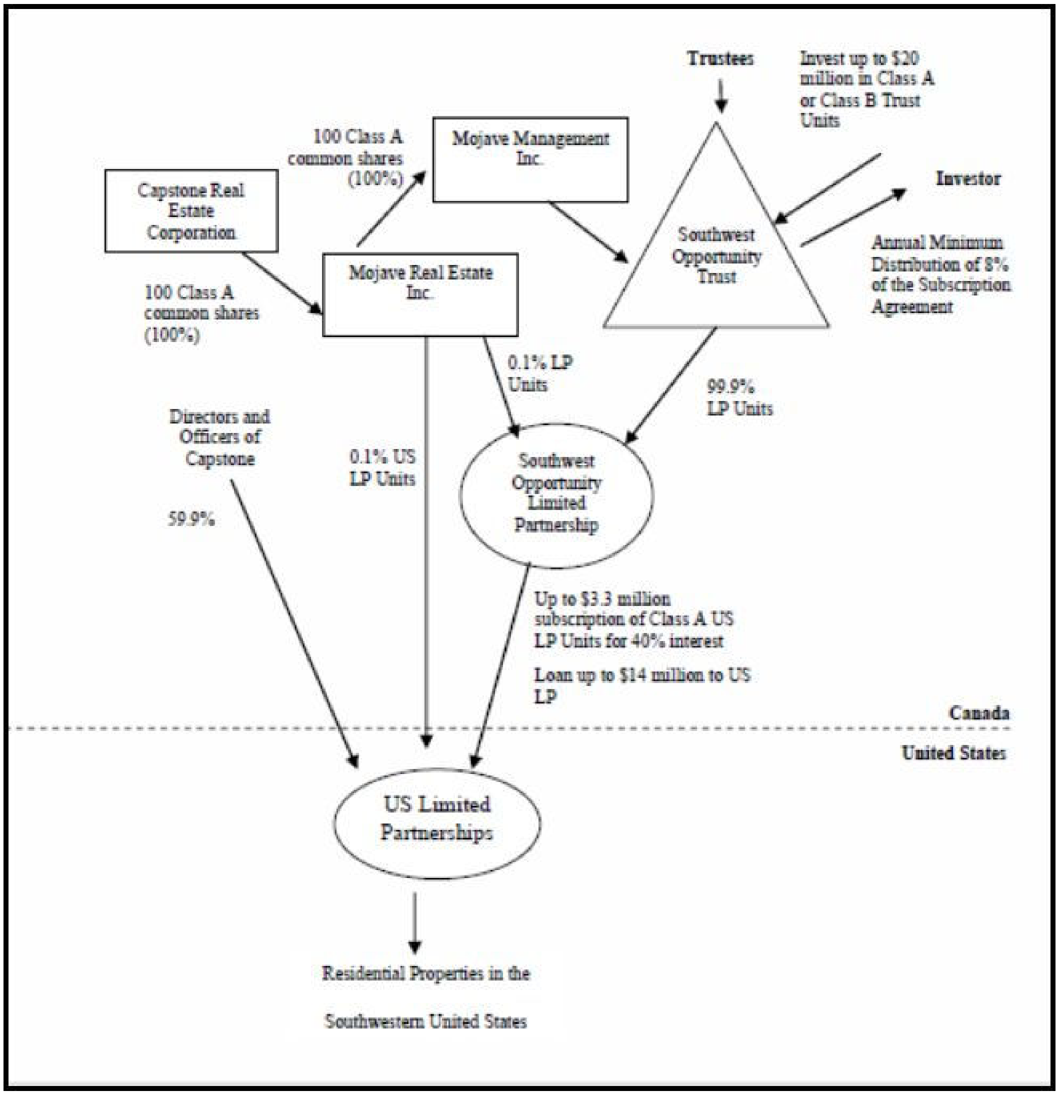
Source: ARMLS

The median monthly rental rate for January 2013 was $1,095 and the average was $1,245, up slightly YOY from $1,090 and $1,237, respectively. We anticipate that the rental market will continue to be strong in the Phoenix area and increase at stable levels of around 2% p.a. We feel that, in the long-term, as the real estate market stabilizes, renters will look to purchase homes.

Overall, we feel that home prices in the Phoenix area will continue to climb, but at a much slower pace than levels seen in 2012. Over the short term (2 years), we expect housing prices to increase by 5% p.a., and then by 3% p.a. in the medium term (3-5 years).

Structure

The chart below displays the structure in which an investment in the Southwest Opportunity Trust flows funds to the US Limited Partnerships to acquire properties in Phoenix.



Source: OM

Investors will purchase Class A and Class B trust units at a price of $100 for Class A and $92 for Class B. The trust units have the same features with the only difference being the Class B units do not pay the 8% selling commission. The trust units are eligible for registered plans.

The Southwest Opportunity Trust will use the funds from the Class A and B trust units to acquire Class A LP Units in the Southwest Opportunity LP ("LP"). The LP will use 20% of these funds to acquire a 40% interest in U.S. Limited Partnerships. It will use the remaining 80% to advance a loan to the U.S. Partnerships, for which it will receive a 13% p.a., or 8% of the total invested capital.

The table below shows the use of funds:

Description of intended use of available funds listed in order of priority	Assuming Minimum Offering	Assuming Maximum Offering
Pay the estimated costs associated with this Offering	$85,000	$85,000
Pay for Selling Commissions associated with this Offering (2)	$32,000	$1,600,000
Pay the Administrative Fee	$16,000(3)	$800,000(3)
Pay the EMD Fee	$4,000(4)	$200,000(4)
Pay the Preferred Return	$13,333(5)	$666,666(5)
General and Administrative	$2,500	$100,000
Subscribe for Class A US LP Units	$49,433	$3,309,667
Loan to US Partnership	$197,734	$13,238,667
Total	$400,000	$20,000,000

Source: OM (review OM for the notes)

The expected net proceeds are $16.55 million (maximum offering). **The main associated costs are selling commissions of 8%, a 1% EMD fee and a 4% administrative fee to Capstone.** The selling commissions and EMD fee of 9%, we believe, are in line with the exempt industry average. Collecting an upfront fee by management is not necessarily uncommon. As Capstone does not charge any annual management fees, we do not believe this should be a concern. To put in perspective, annual management fees of 2% for 5 years (assuming the investment time horizon is 5 years) would approximately translate into 10% of gross proceeds - which is higher than the 4% administrative fee charged upfront.

Management does not feel they will have adequate cash flow to support the 8% preferred return until half way through the first year. For the offering, they have put aside 5 months of preferred return, which is $666,666 of the maximum offering in respect of this.

The OM mentions that the LPs might obtain mortgage financing (or debt) for any properties. Our discussions with management indicated that they do not have any immediate intentions to raise debt at this time. Their business strategy is not to use leverage for acquisitions. The previous two funds for Phoenix did not utilize any debt. The LPs ability to obtain debt (as per the OM) adds more flexibility to management's business model, and therefore, we believe is a good feature.

Management Fee

As mentioned earlier, Capstone does not charge any annual management fees. Management fees include - 1) a one-time fee of 4% of gross proceeds raised, and 2) a one-time acquisition fee equal to $2,500 per property, and a $2,500 disposition fee on each sale. **Management will share 60% of the net profits when all the assets are sold, after all investors receive 100% of their invested capital plus an 8% preferred return**.

According to management, they have not invested any significant amount of their own capital in this offering. Although we would have liked to see management investing their own capital in this investment, we believe the offering's fee structure aligns management's interest with investors because:

a) Management's returns are tied to the profit generated by the portfolio; management does not share in any profits until investors receive 100% of their capital and preferred returns, and

b) As there are no management fees, it is in the best interest of the management team to sell the assets in the portfolio at the optimal time and generate attractive returns for the investors and themselves. Management does not have any motive to unnecessarily extend the time horizon (which normally leads to diminished returns for investors).

Redemption

Investors have the option to redeem trust units subject to certain conditions. The following lists the major restrictions:

- The trust may suspend redemptions for 180 days if they feel it is impractical to payout.
- The annual redemption limit is $300,000.
- The value of the redemption will be based on the NAV (net asset value) of the trust units, as per the most recent financial statements, multiplied by 92% for the Class A units. Class B unit holders will receive 100% of the NAV.

Time Horizon

The investment's expected time horizon is 3 - 7 years; which is when management expects to sell all the assets held in the partnership and distribute the remaining cash flows as profits. As mentioned earlier, we believe the optimal time for investors and management is 3 – 5 years, as this is when we expect the Phoenix real estate market to return to a normal market.

Financial Projections

We have built a model to produce an internal rate of return ("IRR") estimate. The following section discusses our assumptions and the impact they have on the resulting return to investors. The key factors that drive return to investors are the rental yield of the properties, the return on flips, turnover of the flips, and property price appreciation. We have chosen 5 years, as the time horizon, for our analysis.

Rental yields – As mentioned earlier, we have used a net rental yield of 6.8%, with rents increasing at 2% p.a.

Flip Turnover - For our base-case, we have used a turnover estimate of 2 homes per year versus management's estimate of 3 per year. We believe management's estimate is reasonable in the short-term given the current DOM average of 73, and an average time of acquisition to listing on the market of 45 days. We used the 2011/2012 average DOM of 104 days, plus 60 days from acquisition to listing.

Net Profit From Flips - The net return on flips is a significant variable. For our base case scenario, we have used an average gross return from flip of 15%, and net return of 8%. Note that management's net return estimate is 10%. To arrive at our estimate, we assumed that management will be able to acquire properties at a 15% discount to market prices. As mentioned earlier, the current discount for distressed properties is 24%.

The following table shows that the capital deployed for flips should generate a net return of 13.97% p.a. for the trust to be able to generate an overall yield of 8% for investors. A 7% return on each flip with an annual turnover of 2 would meet this goal.

Returns needed to meet preferred return	
Capital available to company	16,548,334
Estimated rental %	60%
Capital to Purchase Rentals	9,929,000
Net Rental Yield	6.80%
Net rental income	675,172
Preferred return payment	1,600,000
Less net rental income	675,172
Return Needed from Flips	924,828
Capital available for flips	6,619,334
Return needed to pay 8% preferred after rental income	924,828
Percent return needed on Flip Capital	13.97%

- *This analysis does not take into consideration the possible price appreciation from the rental properties that will be realized when the properties are sold.*

Property price appreciation - We have conservatively estimated a 30% net (of sales commissions and other fees) price appreciation of the homes over the next 5 years. We arrived at this estimate based on the following – a) as mentioned earlier, we forecast home prices to increase by 5% p.a. in the first two years, and by 3% p.a. in years 3 – 5, and b) assumed management acquires the property at a 15% discount, and that prices will revert back to the market value after renovation. Management expects a 60% price increase over the next 5 years.

Base-case IRR

Based on the key inputs above, we arrived at a base-case IRR estimate of 8.22% for investors. We assumed - a) all the profits above 8% are reinvested at a rate of 60/40 between rentals and flips, and b) US$ / C$ exchange rate of 1:1.

The tables below show our cash flow projections and the key inputs.

Net Rental Yield	6.80%
Net Return Flips	8.00%
Flip Turnover	2.00
Increase in Rent Income Each Year	2.00%
Increase In Price of Rental Properties End of Term	30.00%
Percent of Capital Rental	60.00%
Percent of Capital Flip	40.00%
IRR	8.22%

Year	1	2	3	4	5
Capital Deployed ($)	16,548,334	16,682,599	16,844,549	17,037,488	17,265,102
Net Rental Yield ($)	675,172	694,263	714,888	737,215	761,432
Net Return From the Flips ($)	1,059,093	1,067,686	1,078,051	1,090,399	1,104,967
8% Preferred Return to Investors ($)	1,600,000	1,600,000	1,600,000	1,600,000	1,600,000
Reinvested Capital ($)	134,265	161,949	192,939	227,614	
Cash Flow to Investors ($)	1,600,000	1,600,000	1,600,000	1,600,000	21,855,688

Sensitivity Analysis

The following table shows the sensitivity of our IRR estimates to the different inputs. Our IRR estimate ranges between 2.7% and 10.1% as we vary the inputs individually.

Inputs			**Sensitivity Analysis**		
Net Rental Yield	4.80%	5.80%	6.80%	7.80%	8.80%
IRR	7.36%	7.93%	8.22%	8.47%	8.72%
Net Return Flips	4%	6%	8%	10%	12%
IRR	5.73%	7.07%	8.22%	8.87%	9.54%
Flip Turnover	1.00	1.50	2.00	2.50	3.00
IRR	5.73%	7.07%	8.22%	8.87%	9.54%
Increase In Rent Income Each Year	0.00%	1.00%	2.00%	3.00%	4.00%
IRR	8.16%	8.19%	8.22%	8.25%	8.28%
Increase In Price Of Rental Properties End of Term	-30%	0%	30%	60%	90%
IRR	2.72%	5.80%	8.22%	9.25%	10.11%

Scenario Analysis

We also conducted a scenario analysis to show the expected range of returns.

Scenario Analysis	Poor	Base	Target	Good
Net Rental Yield	5.80%	6.80%	7.50%	7.50%
Net Return Flips	5.00%	8.00%	10.00%	13.00%
Flip Turnover	1.50	2.00	3.00	3.00
Increase In Rent Income Each Year	1.00%	2.00%	2.50%	3.00%
Increase In Price Of Rental Properties End of Term	15%	30%	60%	100%
Percent of Capital Rental	60	60	60	60
Percent of Capital Flip	40	40	40	40
IRR	3.59%	8.22%	12.01%	15.46%

** The 'target' scenario is based on management's estimates.*

Our IRR estimates range between 3.6% and 15.5%.

We also ran a worst case scenario (not shown in table above), where we have assumed that the flips will generate no profit. If this occurs, we anticipate management will shift 100% of their capital to the buy/renovate/rent strategy. In this scenario, we also anticipate home prices do not appreciate. We used a weighted average net rental yield of 5.6% p.a. – properties bought for rental will yield 6% p.a., and homes initially bought for flips will yield 5% p.a. **Given these assumptions, our models gave a worst case IRR estimate of 1.27%.** Property prices would need to decline by over 7% (over the five year period) for the IRR to go negative – which, we believe, is highly unlikely.

Risks

The following, we believe, are the key risks associated with this offering:

- Key person risk.
- No guarantee that investors will receive returns or return of capital.
- Investors have purchased a large portion of homes in Phoenix over the last few years, and could liquidate if there is a shift in market sentiment.
- The trust's business model may not be able to generate a return sufficient to pay 8% annually.
- The time horizon can be longer than the expected 3 – 7 years.
- The new strategy of immediately selling homes requires more active management than the previous two funds.
- Our IRR estimate is highly dependent on the returns from flips and the annual turnover.
- There is no market to trade or sell the trust units.
- Returns are dependent on management's ability to timely deploy capital.
- Exchange rate risks.

Conclusion

Based on our review of the offering, management team, IRR estimate and the risks associated with the offering, we assign an overall rating of 2- (Very Good) with a risk rating of 3 (Average).

FRC Rating	
Base-Case Return (IRR)	8.22% p.a.
Rating	**2- (Very Good)**
Risk	3 (Average)

Fundamental Research Corp. Rating Scale:

Rating – 1: Excellent Return to Risk Ratio
Rating – 2: Very Good Return to Risk Ratio
Rating – 3: Good Return to Risk Ratio
Rating – 4: Average Return to Risk Ratio
Rating – 5: Weak Return to Risk Ratio
Rating – 6: Very Weak Return to Risk Ratio
Rating – 7: Poor Return to Risk Ratio
A "+" indicates the rating is in the top third of the category, A "-" indicates the lower third and no "+" or "-" indicates the middle third of the category.

Fundamental Research Corp. Risk Rating Scale:
1 (Low Risk)
2 (Below Average Risk)
3 (Average Risk)
4 (Speculative)
5 (Highly Speculative)

FRC Distribution of Ratings			
Rating - 1	-	Risk - 1	-
Rating - 2	32%	Risk - 2	-
Rating - 3	54%	Risk - 3	57%
Rating - 4	7%	Risk - 4	43%
Rating - 5	7%	Risk - 5	-
Rating - 6	-		
Rating - 7	-		

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