EPISODE 1523

Arn Cenedella (AC): I was an investor during the subprime crisis, the Great Recession, whatever you wanna call it, and certainly that hurt the value of my assets. But mainly, I didn't lose everything. I didn't lose my portfolio. I was able to weather the storm. These I leveraged the properties properly. I had cash reserves, and when I came out the other end I was glad I kept the properties and now they're worth more than they ever are. So, I'm definitely a proponent of slow and steady and building it in a foundational manner.

Sam Ross (SR): This is your Daily Real Estate Syndication Show. I'm your host Sam Rust. Pleased to welcome Arn Cenedella today. Arn is a long-time friend of the podcast, a real estate broker and investor with nearly 50 years of experience in the real estate industry. He founded Spark Investment Group in 2020, which is a vehicle that allowed him to transition his single-family portfolio into multifamily syndications.

He currently manages and operates a multifamily portfolio as a general partner. It's got over 800 units and close to 100 assets under management, or million that is, and in addition, he's a limited partner and over 500 units scattered across both the Southeast and the Mountain West.

Arn, welcome to the show. Thanks for joining me today.

AC: Yeah. Hey, Sam, good to spend some time with you. And looking forward to having a nice chat about real estate investing.

SR: So Arn, you and I were chatting a little bit before the show about the change in the environment, everybody, unless you're coming out from underneath a rock, you know that interest rates are higher, and valuations are down, at least on single-family homes and on multifamily -- kind of across the board. The euphoric times of late 2021 seem to be officially behind us. And I think that investors who have invested over the last couple of years are coming to grips with the risk profile of the various deals that they're involved in. Right?

And that's something that I hope syndicators across the board did a good job of messaging, that this is not a risk-free investment. Now, there's a lot of reasons. And we're gonna get into some of those reasons today about why we continue to invest in multifamily and why we think it's well-positioned for a recession. But you have 45 years or so experience in commercial real estate.

This isn't the first cycle that you've seen. How do you approach an environment just not even like from a specific, what do you do about interest rates, but just psychologically? You've got all these investments, you're active, you've got some passive investments, you're all over the place, speak to our passive investors, maybe for a moment on just your mindset as the cycle turns as we're headed in a different direction, from your wealth of experience?

AC: Well, thanks, Sam. Sure, I can understand why people are concerned. For many investors, this is a totally different environment that we haven't faced, say in the last 1020 years. And I think the first thing I would say is, this is all part and parcel of kind of a natural economic cycle. I can tell listeners, I bought my first house in 1980. I paid 11 and three quarters percent for my mortgage. And I was happy I made that investment. Eleven and three quarters is about double what people were paying today.

And so I think with real estate, you need to take a long-term perspective. You kinda need to believe in the fundamentals. If we're to look at housing prices, rental values over the last 40 years, the strong trend is up. And generally in my experience, what I've kind of seen is we have five, six, seven boom years, where values and rents increase. And then we typically have one or two kinds of down years where there's a slight pullback from those higher values, at which point kind of a new plateau is established with then sets the stage for another period of six, seven years of growth.

So if we were to look at the multifamily space, we've had exceptional growth over the last 10 years, COVID didn't really slow it down. And so it's natural in my mind that we do have some kind of pullback, but I would encourage investors to keep in the front of their minds the idea that the fundamentals, the housing shortage, the growing population, inflation, all points to continued benefits of real estate investing, and to not pay too much attention to the let's call it day-to-day fluctuations in the market, but instead focus on the long-term perspective of the benefits of owning real estate, cash flowing real estate in new growth markets in the United States. And I think if you do that, you can ride out these kinds of temporary downturns that we are now right in the middle of.

SR: Yeah, I think something that I'd want to highlight out of what you just said, Arn, is the fact that it's a long-term investment play. In so many passive investors, this is kind of their first foray into something that's may be considered an alternative investment, right?

And most people are coming from the world of the 401(k), which is highly volatile, and highly liquid. And so there's this ingrained, some maybe not helpful habit. I know, for me coming into commercial real estate out of that world, you have to adjust your time horizon, you have to adjust your perspective.

And I think it's important to be informed on what's going on in the world. I'm not saying bury our heads in the sand. But also to recognize that fear porn is a real thing. And the talking heads on the various networks, their incentive structures are not always aligned.

And so when you know you're into a longer-term vehicle, just remind yourself of that, as we head into a time that's maybe a little bit more volatile, a little bit more uncertain.

AC: One hundred percent. And I would say, some people say, well, real estate is an illiquid investment. And that's a problem. I would submit for consideration, actually being less liquid, less volatile in the stock market actually has some advantages, because it prevents emotional reactions.

And I can tell you, you're probably too young to remember, but in 1987, there was an event in the stock market called Black Monday. It happened sometime in October '87. So I was probably 33, at the time, probably just about to become a dad and the stock market dropped 25% in one day. I panicked, and I sold all that stock. Now long term, that was a bad mistake. And I reacted emotionally to the current events.

Whereas with real estate, you can't push a button and liquidate assets, so I think it allows people to take a step back and not react emotionally. So yes, it's long-term perspective. I think the other thing I would say is, yes, returns may be a little bit lower the next five years than they were the past five years, right? I mean, I think investors got used to 17, 18, 20% IRRs.

And I would just say, if you can make 13, 14, 15% IRR in a relatively safe investment, during an economic downturn, that's a pretty good return on your money. Most people would be happy with that. So maybe adjust expectations a little bit, still understand you're getting a good return on your investment and long term, you're gonna win.

SR: Comparing to the landscape is important, right? Even when equities are down 20% year to date, and you can get into an investment, even if it's just 10%. That's a really good spread versus, you know, maybe the trailing five-year average where I don't know that statistic for the Dow off the top of my head, but I would imagine it's in the 10-12% range over the last five years.

If you're only beating that by 3%. You know, there's an argument to be had there. But we're not in that moment anymore. We're in a different part of the cycle. So I appreciate it. That's good stuff to keep in mind, Arn. At Life Bridge, we're changing our focus slightly. We've traditionally gone after Rocky Mountain markets that have really high growth, both population which then pushes rent growth up higher, cap rate compression has been phenomenal. And still is compared to some markets around the country.

You know, southeast would be another area that you're very familiar with that has some of the same tailwinds. But I think there's an opportunity for us to be a little bit more judicious and go after some projects that have a little higher yield. And when we say that for the average investor, that's higher cash-on-cash return.

So maybe we're not baking in quite as high of an exit multiple but we're buying projects that have in-place cash flows. I'm curious for your thoughts on that strategy as somebody who looks at a lot of different offering memorandums, and how you're adjusting your own allocations moving into 2023.

AC: Great question. And first, let me just say every investor is unique, right? So each investor has to kind of figure out for themselves, what approach Which what strategy works best for them. So people who are in different stages of their lives may need different kinds of approaches to investing.

So for example, somebody who's 30 starting to enter their peak, W-2 earning years, perhaps they're more concerned with growing equity than cash flow. On the other hand, someone who's 65 may be more concerned with cash flow over equity growth. So, one size doesn't fit all. I think in this kind of market, there is a lot of wisdom to going towards stronger cash flow deals with perhaps less upside.

But if you give up a little bit on the upside, I think with the cash flow, it provides some level of security. And typically what I've seen in down markets -- markets that have gone up more tend to drop down a little bit more, where more stable markets tend to drop less when things go bad, and all be it. There's no free lunch, right? If it's going to jump up like a rocket during a boom, it's probably going to be a little less stable when times turn a little bit rough and similarly as a steady-as-she-goes type market offers protection on the downside.

So one great thing about being a passive investor is you have this smorgasbord of potential investments that you can make, right? So you can really kind of tailor your portfolio and diversify it in a way that makes sense to you. So you can diversify by geography, you can diversify by class, you can do a few more speculative deals a few more steady-as-she-go deals.

And so I think that's really a nice option for a passive investor to be able to kind of pick and choose and create the portfolio they want.

SR: I think that that's really important to highlight is to know what your goals are, begin with the end in mind. And then that will inform what level of risk you're willing to assume, and what level of growth you need to achieve those goals. I'm generally a fan of slow and steady wins the race. So...

AC: Definitely slow and steady will win the race. And we kind of hear people talk about go big as soon as you can -- and I understand that philosophy. On the other hand, I'd ask people that consider, there are benefits to kind of foundational steady growth, and gaining experience in your investing career as you take on bigger and bigger deals.

So I'm definitely a more slow-and-steady guy than shoot-for-the-moon. The way I describe my investing philosophy is line-drive base hits over five, 10, 15, 20 years. You do that, you're gonna win, I don't swing for the grand slam, I don't swing for the home run. I'm just happy getting those base hits, seeing my capital work, seeing it grow, produce some cash flow, and just over time building that financial security and ultimately freedom.

When people get too far out in front of their skis, that's when problems happen. And I was an investor during the subprime crisis, the Great Recession, whatever you want to call it, and certainly that hurt the value of my assets. But mainly, I didn't lose everything. I didn't lose my portfolio. I was able to weather the storm. Besides leverage to the properties properly, I had cash reserves.

And when I came out the other end, I was glad I kept the properties. And now they're worth more than they ever are. So I'm definitely a proponent of slow-and-steady and building it in a foundational manner.

SR: Yeah. And you mentioned this earlier, Arn, but a lot of projects over the last, let's say four years, you know, positive mid-teen IRRs, and then went on to achieve like 40% IRRs. And that was awesome. I celebrate everybody who made that happen.

That's not going to happen over the next two years. And so I appreciate that you were saying temper your expectations on top line going in. But I think a lot of investors who got in two or three, four years ago have experienced some of those wins. Someday, those days will return. That's just the nature of the industry.

But for the foreseeable future, it's going to be much closer to what was in the offering memorandum than the pops that we all got over the last 18 months.

AC: Yes, and I have a good partner Brian Walsh. Have it here in Greenville, South Carolina. And when we look at an investment, when we're talking to our investors, and talking about returns and making projections into the future, we can't really control what happens to the national world economy, we can't control what happens to the local economy, we certainly don't know what interest rates are going to be. So there are factors outside our control that will impact the investment.

That being said, there are factors that we can control. And that's where we have to focus. And most of them are around the operation of the property, right? If we're prudent in acquiring an asset, and we manage it and run it professionally and effectively maximizing its potential, we've kind of met our fiduciary duty to our investors, right? We can't control what the Feds are going to do but we can run those assets properly.

So I think it's important for the limited partner investors to understand how important the team running the asset is. Because that's something that can actually be controlled. Other factors are outside our control. And I think savvy investors understand that life happens, things happen macroeconomics, and that's going to impact returns. And it's good to be reminded that and that's what's happening now. We're being reminded of the reality of life.

SR: Yeah, that is for sure. So I'm curious on how you spend a lot of time, I'm sure, digging into different markets, and you've relocated, you know, in the last decade to Greenville, South Carolina areas. You're familiar with the southeast -- that was very intentional on your part. What's an underrated market or two that you are keeping an eye on as things are shifting?

AC: I actually kind of think there's markets in the Midwest, that may offer some opportunity that will give you both cash flow and some appreciation could be Oklahoma City could be Tulsa, it could be some markets in Tennessee or Kentucky.

So I'm very much focused in the Carolinas. So I don't know that I'll personally do anything outside the Carolinas, but I do see some opportunity there. Specifically in the Carolinas, I would point to the Greensboro Winston-Salem area, known as the Triad. People are more familiar with the triangle which is Raleigh Durham, and of course, Charlotte's on everybody's list.

So there's three big metros in North Carolina, Charlotte, Raleigh, Durham and Greensboro, Winston-Salem. And by far Winston-Salem and Greensboro have had the least heat to them. And so they're not quite as pricey, the returns are a little better. But the factors that drive the Charlotte in the Raleigh-Durham markets are also in play in Greensboro, Winston-Salem.

So, I like that as a market. And I've been spending some time there in South Carolina. I really kind of like outside Charleston in Somerville, which is a little bit inland. And there's Boeing and Volvo and Mercedes Benz. We're up here in the upstate of South Carolina. We have Michelin and BMW. So those are a couple of markets that I hope to get more active in.

SR: I think, the common denominator across really all the markets you mentioned is strong demographics, good employers, and a diverse set of employers, right, that are going to likely weather the coming recession and provide some of that floor for the local economy, which translates into real estate. I mean, I think commercial real estate in many ways, is a bet on that local economy. And so if you have that mindset going in, you can avoid a lot of pitfalls.

AC: Yeah, and I know this is going to be crazy, but I started investing in real estate before there was Microsoft Excel. Okay, now some people may think that's crazy, but I promise I did it. I got a little HP 12C calculator that somebody you folks may know.

And kind of what I talked about investing is one I'm kind of a qualitative investor and I rely on my instinct in my gut developed over many decades. Certainly you look at the data, but for me, there's the deal makes sense today, and do you have logical and rational reasons to have optimism about the future of that market, which kind of circles back to what you said, of finding these industries in diverse economies that will kind of set a floor that will provide the economic juice to improve that region and make that region a good place to invest. So I think that's exactly right.

Figure out what areas you feel optimistic about, about the future of that area and invest your money there. And I think you used the word "bet," one of the great things about being an investor is you actually have to put your money where your mouth is, right? And it's not some theoretical discussion, right?

It's you do your research, you do your investigation, you talk to a million people, you get a sense, you run the numbers, you crunch the numbers, and then ultimately, you make a decision, and you invest your own capital there. So it's a fun process, and you have to believe in what you're doing.

SR: Yeah. And I think sometimes thinking about it in that lens is helpful. Sometimes, unfortunately, in all investments, not just syndication, it's just the niche that we're in, but they can get pitched to share things, right, or the way that people will talk about them, you know, there's this preferred return, and it guarantees this and, well, when you dig in, it doesn't guarantee you anything, it just says if there is growth, this is the first slice that goes to investors, right.

And so introducing, even into our language, some of those types of idioms like you're making a bet on the local economy, I think it's a more realistic picture of what's taking place. But like you said, with your 45 years of experience, and incorporating the data that we now have, it allows you to really get in front of a lot of the issues that can pop up. Now there's other issues unrelated to demographics that can still come and bite you, you have to be a good operator, you have to buy the right property in those markets.

But man, every hurdle you can avoid at the outset is one less that can come nip at your heels and that's really what this game is. How can we minimize our downward exposure? And how can we maximize our upward momentum?

AC: Correct. And the thing I often say to LP investors is, if you were to pick 10 stocks to buy, would all 10 be great deals, would all 10 be very profitable? No, probably two or three would do well, three or four might do very poorly, and the rest might do kind of middle to nothing.

And so I think it's a lot easier in real estate to have a little higher batting average, in picking those 10, you're probably gonna win eight out of 10 and your one or two, let's call them "duds" are gonna be minimal to no loss, right?

Like, in my experience, a poor real estate deal, most times at worst, it's a break-even proposition and we're disappointed. It's not that you lose 50% of your equity. It just doesn't happen in real estate, especially if you're in the right markets. I remember in the Bay Area 2007, 2008 home values on the peninsula maybe dropped 5%.

And this was after eight years of going up 15% a year. So good markets, they're gonna stand up to the time and the real estate's more secure, it's real, you can see it, you know, people have to rent and so there's a lot of things to like about it.

SR: Now, I'm curious, are shifting gears on you a little bit? What has investing in real estate over this long of a time period allowed you to do either and how you order your life on a macro level or micro level the way you can spend your time? Could you elaborate on that a little bit for our investors?

AC: Yes. And it's really why I do what I do now with trying to bring syndication opportunities to passive investors. So through my real estate investing, even when I was a young dad, I was able to have a good work life balance. I was able to coach both my boys Little League and soccer teams and that's out on the fields five, six, 10 hours a week.

So through real estate investing, I've been able to create a life of balance where I am actively earning money, but also the real estate is passively earning income. That kind of created a comfortable, secure life. For me, it's not a jet set lifestyle. I don't go to Bali for four weeks every year. But it has created a good work-life balance for me. It's allowed me to do recreation, spend time with friends and family, give back to the community.

Let me put it this way, coming from Silicon Valley, most of my friends are in tech. And they made great money, no doubt, and they got stock options. But most of them had to work 60-70 hours a week. And in my mind, that's not a sustainable pace. It's not the ideal space. So I think through real estate investing, you can create a little of that time freedom and live life at a little slower place.

SR: Yeah, that's fantastic. Well, I appreciate you sharing Arn. If folks want to get in touch with you, learn more about your journey in real estate investing or what you've got going on in the Carolinas, how can they get in touch with you?

AC: Well, thank you. So it's Spark Investment Group. And you can find me on LinkedIn or Facebook. Email is arn@investwithspark.com. And my cell is 650-575-6114. So reach out, happy to talk about real estate anytime, happy to help any investor achieve the kind of life that they want and help them on their investing journey.

SR: Fantastic. Well, thanks, Arn, for joining us today. Thank you to our listeners for joining us on another episode of The Real Estate Syndication Show. I'm your host, Sam Ross, signing off.

Thank you for being with us again today. I hope that you have learned a lot from the show. Don't forget to like and subscribe. I hope you're telling your friends about the real estate syndication show and how they can also build wealth in real estate. You can also go to Life Bridge capital.com and start investing today