EPISODE 118

[INTRODUCTION]

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Tejas Gosai (00:00:26) -Ladies and gentlemen, welcome to Real Estate Investor MBA. My name is Tejas Gosai, and I've had the honor of helping hundreds of investors achieve the American dream by creating generational wealth through real estate. I've spent the past few years interviewing the most knowledgeable experts I could find in the business to cut your learning time and conquer the hardest subjects in the game. Check out rei.mba, which my team and I have packed with over 75 interviews and free access to our real estate roadmap, webinars and publications. If you're listening, I am rooting for you and you're already on your way to financial freedom. Cheers and happy hunting!

[INTERVIEW]

Tejas Gosai (00:01:16) -We're back. You know, I work my butt off to get the best guests on the program. Arne, thank you for being here.

Arn Cenedella (00:01:21) - Oh, thanks so much for having me. Looking forward to having a good chat.

Tejas Gosai (00:01:25) - For sure. And I'm going to try not to mess this up on the perfect 100%. Yeah. Thank you. As everybody knows, I manage a fund and I'm very active in the multifamily space. I rely on people like Arne because I am younger. I'm in my 40s and there are folks that have survived some insane changes. And we need your knowledge and your information. So, Arn, welcome to the show.

Arn Cenedella (00:01:52) - Thank you. I hope I live up to the good introduction. Thanks.

Tejas Gosai (00:01:56) - I'm sure you will. So, Arn, why don't you just tell us, the listeners how you started, how you got here? And if we want to hear the path. If you don't mind.

Arn Cenedella (00:02:04) - Yeah, sure. So great question. And like many middle-income American kids, I went to college and I did good at college and ended up going to grad school, got a master's degree in physical chemistry, then decided, hmm, I don't think that's really the path I want to follow.

Arn Cenedella (00:02:25) - So I returned to the San Francisco Bay area, where I grew up, and my father had a residential brokerage business in Menlo Park, California, which is basically between San Jose and San Francisco. Some people might know it as Silicon Valley, so I was blessed to sell real estate in probably the best residential market in the world. Did that for 35 years. My father was a single-family investor, so he built a single-family portfolio. Being the good son that I am, I kind of followed in his footsteps. So over the years, I'd use the brokerage income to acquire rental real estate. I started my real estate career in 1978, so the prices were still relatively affordable in the Bay area, and you could actually buy rentals that might make sense. Prices have now probably gone 10, 20 times X, so started buying rentals both in the Bay area. Also was fortunate to find Austin, Texas, which we all know is a great market. And so over that time, I probably ended up with maybe 25, 30 rental properties both in the Bay area and across the country and very happy with them. Did a lot of 1031 exchanges. And then approximately ten years ago, my partner and I moved to Greenville, South Carolina. So we went almost 3000 miles across the country.

Tejas Gosai (00:04:01) - Can I pause you because you skipped over 2008? How did you deal with those issues? Owning that much real estate being pedigree of real estate? Tell me about that.

Arn Cenedella (00:04:13) - Yeah. Great question. My father taught me the investing business and my father was born in 1921. He actually lived through the Depression, the depression with the capital D. So he was very much an old-school fundamental investor. And so my approach to investing has always been long-term fixed rate, that relatively low leverage on your loans. And then the third component is having ample cash reserves. We probably all know what Murphy's Law means, that at the last second or at the worst time, some problems going to pop up. And certainly, 2008 was a very difficult time. My real estate commission income probably was cut in half, if not even a little bit more.

Arn Cenedella (00:05:09) - So that required some personal belt-tightening. But the way I set up the rental properties was they weren't overleveraged, they had positive cash flow, and I had money in the bank to replace the roof, the furnace, the hot water heater. And so I think the lesson of 2008, which is now also being repeated today, though maybe not quite as in a severe manner, is you can't go in to real estate undercapitalized, you can't be overleveraged. And while floating rate debt can be attractive, I think you're a lot better off getting fixed rate debt. So my rental portfolio pretty much survived the downturn. My personal income from the brokerage dropped, but basically the rentals maintained their value pretty much. And more importantly, the cash flow remained. I collected the rents. The rents paid the ownership cost. So.

Tejas Gosai (00:06:15) -You did well.

Arn Cenedella (00:06:19) - Yeah. Yeah. Well, I just, you know, I set it up properly. And I guess the other thing is I've never been one to swing for the fences. I don't try for the home run.

Arn Cenedella (00:06:29) - I don't try for the grand slam. To me, real estate investing is more a long-term game. And if you look at it, a five, ten, 15-year time period, if you set it up properly, you're going to be fairly secure. Generally, what I've seen, we all know about economic cycles, market cycles. And so what I've typically seen in real estate is we have five, six, seven years of boom activity, increasing values, increasing rents. And then we hit a little turbulence and maybe things retract a tad. But I would say if you've had 5 to 7 years of up 10 to 15%, if the market retraces a little bit with a 5% blip, you're okay, you're still net positive. And then there's a period of a plateau. And as long as you're set up properly and can ride through those little turbulent times, you know, long term you're going to do so. That would be the key. And that's what I'm doing now. That's what I did back then.

Tejas Gosai (00:07:43) - Thank you. Thank you for sharing that. Because everyone's hearing some horror stories, even private equity funds. I don't want to speak poorly about a private equity fund, but there are people that made mistakes in the past few years. They had variable debt and then everything just blew up with jobs and people leaving apartment buildings. And Texas is having issues and all that. I'm also very prudent, but I have a little bit of a win over the other folks at my age. I have a 65-year-old partner who was a commercial banker for 30 years, and now he's in the private equity fund world. So he really helped me not make mistakes, I guess. But you know what you're saying. I don't think a lot of people look at it that way. It's always like, next deal, next deal, not thinking about that structure. So that's really what helped you over the past few years. And then Covid kind of happened and you still survived that with the same principles?

Arn Cenedella (00:08:35) - Yes. Essentially I moved into multifamily right about the time Covid hit, which would have been spring of 2020. So for 45 years I was a single-family investor and then moved to multifamily. The multifamily made a lot of sense to me because it's basically the most affordable housing we can offer people in the United States. There are some other alternatives, but generally, it's one of the most affordable. And we all understand there's a housing shortage, and the housing shortage isn't in the $3 million home. The housing shortage is what average hardworking people can afford. And so with multifamily apartments, you know, there's going to be a big section of the population that's going to need that affordable housing. And so I think it's a very secure place to be because everybody needs housing. I think the other thing that's great about multifamily is you can partner with people who have skills that maybe you don't or I don't. And we have a complementary skill set. So the team is stronger than the individual parts, if that makes sense.

Arn Cenedella (00:09:57) - Yeah. And so I made the switch to multifamily. Same thing I would say on most of our existing assets. Now average leverage is maybe 60 to 65% LTV. We probably, on average, have between 5 and $10,000 a door in reserves, which is quite an amount.

Tejas Gosai (00:10:21) - Yeah, that's a lot of money.

Arn Cenedella (00:10:23) - Yes. And so we have it in a money market now and we're gaining our 4%. And I've had my investors ask me, well, Arne, why do you want to raise so much money? Why do you want to have such a large reserve fund? They go, doesn't it decrease returns a little bit and I'll go. Yes. Maybe it knocks a percent off the IRR. Maybe it knocks a percent off the average annual return. But in my mind, the security of having that money in the bank is worth a little bit lower return. And so that's how we structure our deals. Again, low leverage fixed rate debt, ample cash reserves. And we're dandy fine. We have not paused distributions on any of our assets. On all of our assets pretty much were at pro forma or above. And again, it's not that I'm a genius or that my partner's a genius. It's just we've been doing this some time and we kind of know how, how to go about it in a prudent way. And the wisdom of that has been shown in the last year or two. It may not have been the best strategy for 2020, but it's proved to be the best strategy for 2023. And now it looks like maybe going into 2024.

Tejas Gosai (00:11:50) - Yeah, I love you sharing that. And it's cool to meet somebody that was in single-family that long and made the jump not too long ago. How about when you when you mention you made the jump and everything and you're working with other folks, are you syndicating with them?

Arn Cenedella (00:12:05) - So I basically do small syndications or joint venture agreements. I pretty much limit my activity to Greenville, Spartanburg and South Carolina. It's it's a region up in the northwest part of the state, maybe nine counties, maybe a million people an hour, hour and a half from Charlotte and Atlanta on I-85.

Arn Cenedella (00:12:32) - BMW’s here, Michelin's here. It's a boom market. Plus it's a great place to live. So again, kind of getting back to an old-school fundamental. We all know the expression location, location, location. And so what I would submit is having knowledge of the markets you're working in is critical. If you have good market knowledge, that's kind of your competitive advantage. So we simply do Syndications and joint ventures in Greenville County, which is where I live. And my operational partner, who's 48, he takes care of the kind of day-to-day thing. So we do both our Syndications are 506 B, we're typically doing 3 to $5 million deals.

Tejas Gosai (00:13:23) - Let me pause you. What's a 506 B?

Arn Cenedella (00:13:26) - Oh good question. So there are two kinds of syndications typically offered. The one most people know about would be the 506 C, as in Charlie. Those are for accredited investors only. They can be kind of advertised on the open market. To be an accredited investor, you need a net worth of over $1 million exclusive of your personal residence, so the value of your home doesn't enter in to that calculation.

Arn Cenedella (00:14:00) - Or if you're an individual, $200,000 a year of income, a couple, I believe, is 350, with the expectation that that income will continue. So 506 C are for accredited investors only. The other alternative is 506 B, which is open to accredited investors and also so-called sophisticated investors. What is sophisticated investor is, is someone who has enough financial knowledge and experience in investing that they can properly determine, evaluate the risk of any investment so they're informed consumers. And basically the SEC that regulates this has put these regulations in place to help protect the consumer of investment products. The other thing on the 506 B is you need to have a prior relationship with an operator. So you just call up on the phone, you got a deal. Yeah. Let's invest. More what it is, is somebody like me would actually have to kind of get to know the potential investor, understand have they own stocks, have they own rental property before what's kind of their financial situation. Because most of these real estate investments are longer-term.

Arn Cenedella (00:15:36) - It could be three, five, seven years. And so investors should only invest in these kind of longer-term real estate deals if they have enough financial backing to handle their day-to-day demands, their life, whatever issues may arise, because this money is being put to work long term and it's not immediately liquid. So we do 506 B's because there are a lot of younger people who want to invest in real estate, maybe are too busy at work to. Too busy raising their family to really learn and do it themselves, and or they lack the knowledge of how to do it properly. So they're making good money, they understand real estate is a good thing for them, and people like us offer these investors opportunities to get into real estate. And I think the other thing I would say is I never asked somebody to put all of their nest egg into real estate. I believe in diversification as we are talking about this somewhat unsettled economic environment we have. I think diversification is a way you can reduce risk.

Arn Cenedella (00:16:53) - You can never eliminate it, but it's a way to reduce it.

Tejas Gosai (00:16:57) - Love it, love it. Everything you just said. I'm happy the show is transcribed so people can read that. Well, here, catch me up then. So you pool capital. You got this thing going. You're in specific markets. What? You said multifamily, but how big? How small?

Arn Cenedella (00:17:13) - Yeah. Great question. So unlike many operators, my company, Spark Investment Group, has this very narrow geographic focus in Greenville County. And so in a smaller market, the universe of available properties is smaller than it would be in Dallas or Charlotte or Phoenix, wherever people like to invest. So for us, we will buy assets of pretty much any size. About a year ago, we closed on 281 units in Greenville was about a $35 billion deal. That was the biggest one we've done. Two months ago, we closed on seven units in a great location near downtown, where the single-family homes go for $1 million. And we just know that area is gold.

Arn Cenedella (00:18:09) - And so even though it's seven units, it's still worth owning. It's going to be a profitable investment. We kind of buy any size, and we own assets built in the 70s, the 80s, the 90s, the 2000s. We just closed today on ten brand new, new build duplexes. So we've kind of moved to the new product. And that's a whole discussion, could be a whole discussion by itself. But the last couple acquisitions have been new product, which we think offers some great long-term potential because I think the days of flipping these apartment buildings every 2 or 3 years is not going to come back anytime soon. So I think one needs to approach it with a little longer-term perspective. And of course, having new product is great. I bought new duplexes in Austin, Texas back in 2010, did great on those and so we like the newer product and we're happy to pick them up in whatever chunks we can. These the other thing I would say is since our territory is very small, we have our team in place.

Arn Cenedella (00:19:28) - So we have the property manager, we have the renovation contractor. So if we pick up a little ten-unit deal, we don't have to reinvent the wheel and figure out how to run it. The team's already in place where if I was to go up to Greensboro, North Carolina, which is a great market, I'd have to invent a whole new team, which, as you know, can sometimes be difficult and have some growing pains because it takes a while to find the right teammates to execute the game plan.

Tejas Gosai (00:20:02) - Yep. I totally understand that we're similar in that I only focus in eastern Pennsylvania, and it's actually mainly two counties, so I'm in a very tiny bubble. Biggest properties we've bought are 20 units, the smallest ones, like we just bought a three-unit. But I like that, you know, I obviously, I have a podcast. I talk to a lot of folks and there's all these multimillion-dollar numbers out there. And I'm like, but what's your return? Are you doing any capital calls? How's your floating rate doing? Right?

Arn Cenedella (00:20:33) - You know your market. You know, your market street by street. Right. And that makes a difference. What I always tell people is you want to invest in neighborhoods before they become front-page news, right? Because once the word is out, everybody and his brother from all over the world is trying to invest there. So in our individual markets, we can identify neighborhoods that maybe are kind of C plus, B minus maybe. But we see single-family home flippers going into those neighborhoods, renovating those homes. We see that abandoned storefront turned into a hipster coffee shop. You only really get that insight if you're actually living there and know the community. So the other thing I would say, what I tell aspiring investors is drill deep in a limited market, in a specific market, than spread yourself thin over eight markets, because in your market, the brokers know you by property, you know the property managers, you know other owners in that. And so there's this synergy where you're getting exposed to the deal first because they know you and they know you're close.

Arn Cenedella (00:22:04) - So I think it's a great thing. And it's the approach I use. It sounds we're kind of similar that way.

Tejas Gosai (00:22:10) - I love you sharing that. I don't think enough people do, because I do have a lot of folks on here that are all over the country, and that is, I don't know when I'm going to go outside of even eastern Pennsylvania. Like there's so much to mine here. I'm happy you use that term.

Arn Cenedella (00:22:25) - What I would say is if you as an operator determine Chattanooga, Tennessee's going to be your market, you can go in there and buy that first property with the plan of it being kind of a stepping stone to further acquisitions. The other thing I think is it has to be logistically accessible to you, because if you have to hop on three different planes to get to a market, you're not going to do it. I hate to fly. That's one of the reasons I only work in Greenville. I love driving to these properties. If you're investing out of area, there are some logistical issues that you really have to look at and determine.

Arn Cenedella (00:23:11) - Is it really practical for you to properly manage this stuff? Because I think we all know if people don't pay attention to stuff, stuff can go awry, right? And if you're on site on a regular basis, you can identify problems before they get too big. You've really got a sense of what's going on. So I think that kind of local knowledge adds security to the deal. In April, we had a day here where it rained all day. Not really a storm, just heavy rain. We had a tree come down in one of our buildings and a 30-unit building that we own the properties five minutes from my house. The property is five minutes from my partner's property management company, and we actually had a tenant in the building. Drive over to my partner's office and say, a tree just came down. Okay, this was at 3:32 in the afternoon, and in Greenville it rains. We get 48 in a year. So it comes down okay. By 4:00, Brian's maintenance crew was up on the building installing a tarp.

Arn Cenedella (00:24:28) - If we were 300 miles away or 3000 miles away, we just wouldn’t have been able to react as quickly. So just being there, being able to get on-site, your residents like it too, because they want to know they can contact somebody when there's an issue.

Tejas Gosai (00:24:47) - Yeah, absolutely. You're nailing everything of it. These are all really ingredients of your success. And it's amazing that you've gotten to this point. I got to ask some fun questions as we get towards the end of this. The world is in chaos, wars, politics. We're in an election year. Our internet is not safe with how much advertising there is. What do you see happening right now and anything you could give us your guidance on over the next 12, 18 months?

Arn Cenedella (00:25:16) - Oh geez. I'm generally an optimistic person. This may sound corny, and I don't mean to be political, but I believe in the fundamental goodness of the American people and their ability and their drive and their motivation and that. And so part of me kind of understands these people in Washington can do whatever the heck they want.

Arn Cenedella (00:25:42) - It doesn't matter. That average American with a dream is going to keep chopping wood and trying to succeed. So I have great faith in the American people, in the American economic engine. We can talk about China, but we're starting to see cracks in China. And of course, the data you get from China, you can't really trust because they're going to tell you whatever they want. So I believe in the American economic engine. In terms of real estate, I think we're going to be in a choppy period for the next 12 to 18 months, and I think it's primarily tied to interest rates. And I paid 11.75 for my first home loan back in 1980. So I'm not going to freak out when the rate is at 7%. I think the fed is kind of signaling we're not going to drop rates as quickly as everybody had hoped. And so where maybe a year ago we thought rates would drop 2024. I think the conventional wisdom now is maybe 2025. So I think we're going to have choppiness and turbulence in the apartment market, in the commercial real estate market, in the home sale market, too.

Arn Cenedella (00:26:57) - That being said, I think at some point rates will come down. People might say, I'm going to sit on the sidelines until I know we've hit the bottom of the market. And in my experience, you don't know the bottom of the market until it's 6 to 12 months in the rearview mirror. The other thing I've seen in my career is when the market does turn, it turns quickly. So while you're waiting for the bottom, by the time you know about it, the cat's already out of the bag. So for me and Spark and my partners and our investors, we're being selective on what we buy. But we're willing to buy today. Even understanding there could be a little bit further drop in value over the next 12 months, because for us, the finish line is in a year from now, the finish line is 7 to 10 years from now. And so what I would say is if you can pick up good quality property in good locations and pay a fair price for it and set it up properly like we discussed earlier, go ahead, buy that property.

Arn Cenedella (00:28:17) - Because when we get out of this period, I can almost promise you you're going to be glad you bought that property back in 2023 or 2024, because in 2026 it's going to be more. We also talked there's probably a little bit of oversupply in the apartment market now. And yes, there is, but the truth is nobody's coming out of the ground now. So again, it's a short-term oversupply that will be absorbed. And two years from now we won't have any new product coming online or just minimal. So again, take a long-term perspective. And that's how I would approach it. And I would say focus on what you can control, what the crazies in Washington, D.C. do, what they're going to do. And, and, you know, hope for the best.

Tejas Gosai (00:29:11) - Oh, I appreciate that. That's good to hear your insight. I love your story. It's very cool to see you. You're the first person I've met that did single-family that long that jumped into commercial this successfully.

Tejas Gosai (00:29:22) - I love it, I love it because I don't think that I think more people should do it. Multifamily has been such a gift for us, you know, through Covid, through all of this. And I think it's so necessary right now to have good, decent housing. It's not about like I could charge an arm and a leg. That tenant won't leave. They just won't leave. And you want that tenant to be there. These people are paying your checks.

Arn Cenedella (00:29:44) - The biggest cost, or one of the biggest costs for a landlord is turnover and vacancy. If you can keep tenants in place, good tenants who take care of the property, who pay the rent on time. And the other thing is I take pride in my properties. I'm sure you do too. We're members of the community. I take pride in fixing up a building and providing a nicer place for people to live. You can treat tenants with respect, courtesy and consideration and still do good business for your investors. In apartment communities where the tenants get along and everything works and things are peaceful, they attract their friends and family there and it just makes it a better operation.

Arn Cenedella (00:30:36) - If you get 3 or 4 bad tenants, they can cause trouble. So when you don't maintain your property, you don't get good tenants. It's a way to kind of bring problems on you. So we owe it to them legally and ethically to provide good, safe housing at a fair price. And everybody wins.

Tejas Gosai (00:30:58) - I love it, Arn. You are a brilliant man. How does somebody invest in you and your company?

Arn Cenedella (00:31:03) - Well, my company is Spark Investment Group. My website is investwithspark.com. I'm also all over social media – LinkedIn, Facebook. So reach out. Happy to help people who are moving into the active space, as well as people who want to just continue in a passive role. Happy to talk to anybody about real estate.

Tejas Gosai (00:31:26) - Love it, love it and everything is in the show notes or our social media posts. Um, you can find all the information in rei.mba. Arn gets our big stamp of approval. Thank you. Thank you very much.

Arn Cenedella (00:31:40) - Thanks, Tejas.

Tejas Gosai (00:31:41) - For sure. It's Real Estate Investor MBA. We're all over the place. We appreciate you guys for listening. Cheers.

[END OF INTERVIEW]

