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A MUST-HAVE FOR EVERY RETIREMENT INVESTOR'S TOOLKIT

4 GREATEST CHALLENGES FACING THE SELF-DIRECTED IRA REAL ESTATE INVESTOR

FIRST EDITION

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Introduction

Around 2007, we started to notice a strong emerging trend among the mom-and-pop real estate investors who were buying our tax incentive real estate opportunities. More and more investors were buying real estate within their self–directed retirement accounts. By talking to and listening to our clients, we were able to recognize several unmet needs and challenges in that portion of the real estate investment space. In order to help those clients, we decided to take action and become expert in the ins and outs of self–directed individual retirement account requirements Having helped self–directed investors invest more than $150 million in real estate across {insert number of markets} markets, we have developed solutions for the challenges facing the self-directed investor.

This eBook is designed to help the self-directed investor understand the common challenges we have seen investors face over and over again, as well as the solutions our company Growth Equity Group has created to help our clients be successful real estate investors. It begins with a simplified discussion of self-directed retirement accounts and the rules surrounding them. After that, we discuss the four biggest challenges we see facing SDIRA investors. Accompanying each challenge are the solutions we found for SDIRA investors.

What is a Self-Directed Retirement Account?

A self-directed retirement account is a retirement account that allows the account owner to purchase alternative assets such as precious metals, real estate, private equity, notes or tax liens. Most people do not realize these retirement accounts exist because their financial planners or retirement advising companies tell them is that all they can buy are the paper assets (usually mutual funds) the retirement company is promoting. However, people have been able to buy real estate in a self-direct account since 1974!

As a matter of fact, real estate can be purchased in any self-directed retirement account (IRA, 401k, SEP etc.). For simplicity, the rest of this eBook will refer to all accounts as either “self-directed IRA(s)” or “SDIRA(s)”.

What is are Prohibited Transactions

A real estate investment purchased in a SDIRA has additional restrictions that a regular real estate investment purchased outside a SDIRA does not have. The IRS states that a SDIRA cannot engage in any prohibited transactions with a "Disqualified Person". For a thorough and in-depth discussion of prohibited transactions and disqualified persons we suggest reading our other ebook **Don't Risk It**

Here is the simplified version: The IRS considers the investor and most of his or her relatives to be disqualified persons. A disqualified person cannot gain any benefit from the investment, and the investment cannot gain any benefit from a disqualified person. For example, a disqualified person cannot extend a line of credit for the property, cannot use the property for personal gains, and cannot do any services or work on the property. Every transaction in the SDIRA must be at arm's length.

Again, this is a simplified discussion that serves as background information needed for this eBook. We suggest you take the time to read **Don't Risk It** as it does a great job detailing self-directed retirement accounts, disqualified persons, prohibited transactions as well as the possible penalties that could be incurred as a result of performing a prohibited transaction.

CHALLENGE 1

Challenge: No Financing Available or Financing With Bad Terms

Deeded real estate investments held inside a SDIRA offer many benefits over other investments. One of the biggest benefits is the ability to use other people's money by utilizing leverage. When the investor has less cash invested, the ROI (return on investment) is naturally higher.

If you have tried to get a loan recently, you have probably found that you need to provide everything short of a blood sample to get approved. Even Ben Bernanke, former chairman of the Federal Reserve, was recently declined on a real estate refinance loan!

Most loans provided by conventional lenders are called a recourse loan, because the lender has recourse action that they can take against the borrower if they do not make payments, and foreclosure ultimately occurs. The bank is qualifying you, the real estate buyer, because they might have to take recourse action against them personally. The bank wants proof that you are going to be a good borrower, and that they will get their money back. That is why they check credit and financial histories income, employment status, and so on and so forth.

If an investor is buying real estate with their SDIRA they need what is called nonrecourse financing. As the name implies, with a nonrecourse loan the bank has no recourse against the borrower. Their only recourse is to take the property if there is a stoppage in payments. Nonrecourse financing, therefore, is a loan based on the quality and the qualification of the asset (the property) not the property buyer or borrower.

Per IRS tax code, nonrecourse financing is required for SDIRA real estate purchases because the buyer cannot extend his own personal credit on a property held in a SDIRA. This is that required arm's length separation discussed earlier (in the prohibited transaction section.) As you can imagine, these nonrecourse loans are incredibly difficult to obtain. Banks are barely lending recourse, let alone nonrecourse! The property has to be a amazing investment to get approved for a nonrecourse loan because the bank is making sure it will recoup its money. The same diligence that a lender would normally use on the borrower is performed on the property.

Finding a nonrecourse lender is also a problem. Conventional banks laugh you out the door if you go in asking for a loan without a personal guarantee. Hard money loans (WE NEED TO EXPLAIN THIS) are extremely expensive, often coming with mandatory points and double digit interest rates. Occasionally hard money loans will still do some background checks on you.

If you spend some time researching nonrecourse financing you may find that there are one or two banks that do offer "nationwide nonrecourse financing". We applied to get nonrecourse loans for our clients from these banks countless times. Rarely were our clients approved. Worse, there was no real rhyme or reason. If we had three identical houses, same street, same comps, same mortgage, one would be approved. We determined the only reason for this behavior is that these smaller banks have limited resources and funds. It is very difficult to get a nonrecourse loan from them as the lenders are cherry picking the best properties. This means they are turning away many excellent investments simply because their funds are limited. Also, even though they say they are nationwide, a lot of their investing is in their backyard. The majority of applicants for nonrecourse loans from these banks get denied.

This led to us realize that most self-directed investors have to pay all-cash for the property, which results in losing out on one of the biggest benefits real estate investing provides. If they do get financing, it is often with a hard money lender who takes most of the profits. Alternatively, they may no longer be able to afford the investment.

SOLUTION

After watching hundreds of thousands of self-directed investors get turned down for financing, we realized there is a large unmet need in the space that needed to be addressed. Another means of obtaining nonrecourse financing needed to be established.

Due to our extensive network and experience in the residential real estate industry, we knew we had the ability to help these investors. We decided to not just sell the investments hoping the buyer could secure nonrecourse financing, instead we decided to be proactive. We would take on the hard work and find the financing for our investors on the properties we sell. Furthermore, we would only secure our investors nonrecourse loans with excellent terms so our clients could realize the strong cash-flow being produced from their investment.

How are we able to get these properties approved for affordable nonrecourse loans? Without giving away our propriety secrets, we can say it stems from a combination of the following factors we have:

- **A successful track record of millions of dollars of real estate investments nationwide, including buying, selling, managing and developing.**
- **Prior relationships with lenders who understand how we identify the right properties at the right time and price.**
- **Bulk buying power which results in SIGNIFICANT equity positions for the end buyer.**
- **Phenomenal assets in phenomenal markets.**

There is another important benefit to being able to utilize lending, or leverage, when purchasing income properties as part of a SDIRA that should also be considered. Using leverage can have a tremendous impact on your overall investment returns, yet many investors don't understand or underestimate its impact. Over the years, we have come see many less-experienced investors who believe that they will generate greater returns if they pay all-cash for the property as compared to using leverage. With the right financing, this simply is not true. To help demonstrate the significance of leverage, please see the following numbers. These are actual numbers on a property one of our clients recently purchased.

CASH VS LEVERAGE

ALL CASH PURCHASE

Purchase Price	$97,900
Amount Invested	$97,900
Income & Expenses	
Monthly Gross Rental Income	$970
Monthly Non-Recourse Mortgage	$0
Monthly Property Taxes	$70
Monthly Homeowners Association	$160
Monthly Management Expense (8%)	$70
Monthly Maintenance Expense	$25
Monthly Net Cash Flow	$645
Yearly Net Cash Flow	$7,740
Principal Reduction / year	$0
ROI/year (zero appreciation)	8%
Appreciation based on 10yr market average 4.42%	$4,327
Total IRR per Year	**12%**

2 PROPERTIES WITH NON-RECOURSE LEVERAGE

Purchase Price	$195,800
Amount Invested	$87,000
Non-Recourse Mortage	$108,800
Income & Expenses	
Monthly Gross Rental Income	$1,940
Monthly Non-Recourse Mortgage	$584
Monthly Property Taxes	$140
Monthly Homeowners Association	$320
Monthly Management Expense (8%)	$140
Monthly Maintenance Expense	$50
Monthly Net Cash Flow	$706
Yearly Net Cash Flow	$8,472
Principal Reduction / year	$1,606
ROI/year (zero appreciation)	12%
Appreciation based on 10yr market average 4.42%	$8,654
Total IRR per Year	**22%**

As you can see in the above example, in the left column the investor is paying 97,900 cash for one property. His monthly mortgage payment is $0 dollars a month. Alternatively, using the nonrecourse financing approved on the properties, investors can purchase 2 properties for $87,000 down.

First benefit of leverage: By buying two properties with leverage, he has an extra $10,900 to invest elsewhere. Second benefit of leverage: Even with a monthly mortgage payment of $584, he gets higher total monthly cash-flow ($8,472vs $7,740). Third benefit of leverage: Every mortgage payment reduces principal. Tenants are paying down his loans! Fourth benefit of leverage: He now has 2 assets, both with a great equity position and both appreciating! Imagine his return when he goes to sell!

CHALLENGE 2

Challenge: Property Management and Repairs

As discussed in the prohibited transaction section, SDIRA real estate investors cannot provide any services to the properties held in their SDIRA. This includes repairs, or property management services. Many investors mistakenly believe that there are loopholes that would allow them to manage the property. Some of their misconceptions include not being paid to manage the property, having an IRA LLC, or plain simply believing that they won't get caught. Our ebook, **Don't Risk It**, addresses the fallacy of these.

Because SDIRA investors cannot manage the tenants nor handle repairs themselves, they must hire both a property manager to manage the property and a contractor for any repair work. Many of these investors do not have the experience and/or knowledge necessary to identify a good property manager and contractor. In addition, they also don't know when they are incurring unnecessary charges. Also, for investors who are buying properties outside of their local market, a lack of effective communication with property managers can mean the investor cannot keep a finger on the pulse of their property.

SOLUTION

Growth Equity Group sells properties that have been recently renovated, mitigating a lot of the repairs a SDIRA real estate investor would face. Renovations are also a lot cheaper when you have a healthy home owner association (HOA) that has recently completed a total rehab on all units within the last two years.

Additionally, Growth Equity Group offers our award-winning GEG Manager® to their clients at no additional cost. GEG Manager is our online management tool that allows investors to monitor their property managers and contractors. Growth Equity Group identifies the best property managers and contractors to provide the its clients with the best care possible. With GEG manager investors have a consistent point of contact helping them stay informed about their investment.

Through the website www.GEGmanager.com clients can keep track of their properties and any expenses incurred. They can also track profits earned. GEG manager makes real estate investing as simple as tracking an online investment account.

GEG Management's main function is to ease the day to day difficulties of managing your investment properties. Though we have property managers in place at our various investment communities, it can often be difficult, as an owner, to keep track of the managers themselves. This is where GEG Management steps in. We're not just collecting rent, we're here to preserve, protect, and enhance the owner's investment. In order to minimize your risk and assure that you have the best tenants possible, we offer a thorough tenant screening process which includes background and credit checks, rental history verification, as well as verifying prospect financials.

CHALLENGE 3

Challenge: No Team/Lone Ranger

It is common to see real estate investors take a lone ranger or jack of all trades approach with their properties. They serve as buyer, buyer agent, property manager, contractor, electrician, marketer, landscaper, seller and seller agent.

There is an old saying: “Jack of all trades, master of none.” It is tough to do all these and still be successful. Many new investors begin investing in real estate as a way to make a lot of money, but do not realize the amount of work required to successfully invest in real estate.

The big problem with this approach is not only is the investor spending their free time fixing up houses, if the property is in their retirement account these would all be considered prohibited transactions, as the investor is a disqualified person and is providing a service to their investment.

SOLUTION

At Growth Equity Group, we have built the best team available for our clients. Understanding they want the best return on their money, while still needing A+ service. When we help our clients enter a market, we find the best agents, contractor and property mangers in that market.

Our analysis also extends to the HOA, a huge part of our investors' team. We want to make sure the HOA is healthy, has reserves, and takes care of the properties so that our clients have reliable and consistent expenses and cash-flow.

Not only that, with the Growth Equity Group's total solution, our clients have an entire team in place including points of contact for their SDIRA, at Growth Equity Group and at GEG manager. There is no 1-800 number round robin customer service adventures here

Finally, our clients are able to leverage our 25 years combined real estate industry experience. Over that time and the amount of properties we have transacted, we have fostered relationships that simply couldn't be realized by most individual investors.

CHALLENGE 3

Challenge: Barfy Backyards

Out of fear and lack of experience, many investors are afraid to leave their own local market or backyard. They look to get properties right down the street from them, even when they can't service their SDIRA properties regardless of where the property is located.

This results in many investors choosing to stick in their own backyard regardless of how good another market is.

When buying any investment you obviously want to buy low and sell high. But a lot of investors buy in markets that are showing little or no growth. Worse they might be buying in a market that is trending downward. Maybe the population of their backyard is decreasing. This would result in a smaller tenant pool, which results in greater vacancies and lower rent. Even some other turnkey investment firms are only comfortable with their backyard. We have seen some companies continue to push rental properties in markets that have not seen any appreciation in years rather than follow the money.

Not only that, many of these properties have not been renovated recently. Imagine building up solid cash-flow for years, and then suddenly it is all gone because you have to replace the roof.

SOLUTION

In 2007-2009, we successfully developed nearly $100 million of real estate along the coast of Mississippi and sold it to individual investors. This was a great opportunity for investors for two reasons: first, there was a shortage of real estate due to the repercussions of Hurricane Katrina. Also, investors received a 50 percent depreciation bonus the first year. Investors were basically trading tax dollars for a property.

Once the Gulf Opportunity Zone Act of 2005 (50percent bonus depreciation) ended, we took those same principles that made us successful in Mississippi and expanded them nationally. By constantly monitoring more than 25 markets at any given time, we can identify the best location for our end investor's dollar and focus in on opportunities.

At Growth Equity Group, we are experts at identifying markets near the bottom and on their way up. We are not afraid to look outside of our backyard (in fact, we won't touch our backyard! Nothing kills cash-flow like the strong possibility of getting your property taxes doubled because the city of Chicago is underwater in debt.)

We only look for markets with less than 6 months' supply of real estate on the market, and generally only buy in markets with less than 3 months' supply. This results in a large supply of tenants, and rents rising. Many of our tenants lock in multiyear deals so that they can prevent rents from rising. A 5 year lease is a great hedge against vacancy!

Additionally, in these markets that have limited supply of real estate, they are generally building more properties to meet the demand. As the cost to build rises, these properties will become the comps that raise the prices of homes in that market. Part of our analysis is monitor building permits in the market. This is important. By monitoring this, we can see when and where builders are going to build to meet the demand for more housing.

A clear example of how this was beneficial for our end investors occurred on our recent Ft. Myers property. At that development, we were selling properties that had started to be built at the end of the crash and were not finished because the bank would not give the developer another loan. When we bought them they were empty shells.

We went in and finished the development of the property, so they were brand new 2013 construction. By monitoring building permits we noticed that there was new construction plans right down the street from our property. Those new constructions were the only new construction comps in the area. Our investors who bought that project were buying in $15 dollars per square foot cheaper than the new buildings equivalent comps. By knowing what was going on in the market we were able to get our clients into a huge equity position on brand new real estate. As you can imagine, those deals don't stick around for very long!

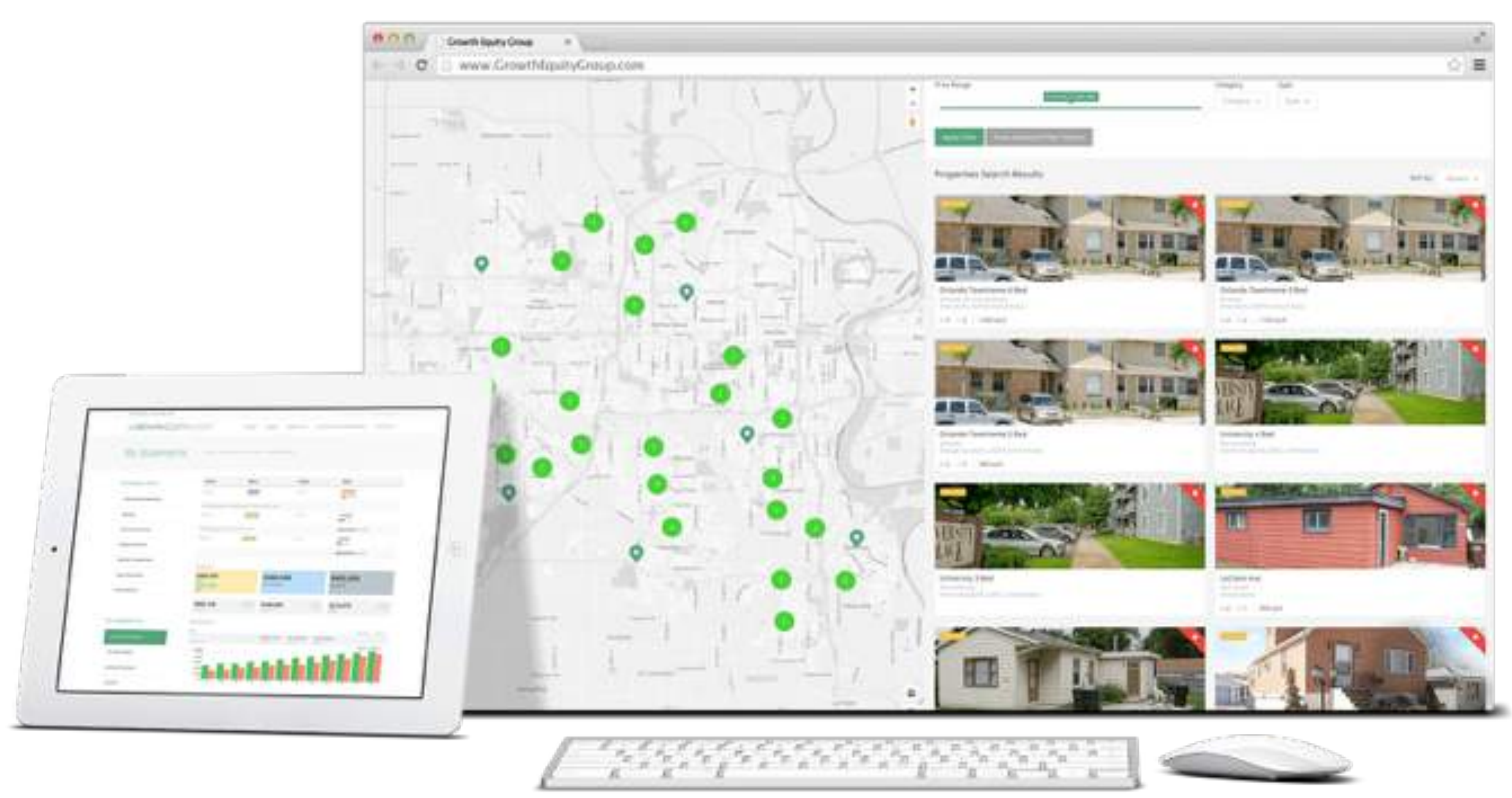
USEFUL LINKS

Don't Risk It

DOWNLOAD

GEGManager

DOWNLOAD



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