EPISODE 391

[INTRODUCTION]

[00:00:00] ANNOUNCER: Welcome to The Real Estate Syndication Show. Whether you are a seasoned investor or building a new real estate business, this is the show for you. Whitney Sewell talks to top experts in the business. Our goal is to help you master real estate syndication.

And now your host, Whitney Sewell.

[INTERVIEW]

[00:00:24] WS: This is your daily Real Estate Syndication Show. I'm your host, Whitney Sewell. Today, our guest is Kaaren Hall. Thanks for being on the show, Kaaren.

[00:00:32] KH: Thank you, Whitney.

[00:00:33] WS: Yeah. I'm looking forward to this. I appreciate your time. Kaaren has a background in property management, real estate, mortgage loan services, and origination, in addition to 12+ years in the self-directed industry. She has helped tens of thousands of investors understand the power of self-directed investing and serves on the Board of Directors for the Retirement Industry Trust Association. Her company, uDirect IRA Services, has over half a billion dollars in client assets. That's a lot, Kaaren.

[00:01:04] KH: That's a lot.

[00:01:04] WS: That's a lot.

[00:01:05] KH: I had to get a bigger bank.

[00:01:08] WS: Yes. Or start your own bank. Tell the listeners a little more about who you are and who uDirect IRA Services so that we can get a little background on you and dive into this self-directed stuff that it’s so important in our industry that we need to know about.

[00:01:20] KH: Thanks. First off, I'm thrilled to be here. I founded the company in 2009 here in Orange County, California. But over the years, over the last 10 years, because we just had our 10-year anniversary, we have accounts in every single state in America. So, we are national, and that's awesome. So, we have about over 5,000 account holders happily self-directing their IRAs. We could talk about due diligence for those that are not so happy, but it’s risk with investing. But it’s with thousands of account holders building their retirement, which is just so incredibly crucial.

Self-directed IRAs are for retirement purposes only. That's why you use them — to save money for later on. They talk to make money today, and that’s a common misunderstanding. So, either you're using your self-directed IRA to build your retirement or what you're doing is you’re using other people's money. So maybe you're tapping. Especially if you’re a syndicator, tapping into some of like $30 trillion in American retirement money. I mean, it's so much money in the American retirement pool, and only about 3 or 4% of this pool is tapped for what’s called alternative assets, basically meaning not the stock markets, not CDs or something like that. So alternative assets, a huge opportunity to raise capital from these self-directed IRAs.

[00:02:35] WS: What's the best way to tap those millions? I know so many people that are listening are wanting to raise capital. How do we do that? Give us a couple tips.

[00:02:43] KH: Yeah. Well, I think when you're talking to somebody who’s an investor, you want to ask them, “Do you have an IRA or do you have a 401(k) with your previous company?” Because if the answer is yes, they can invest in your deal, and they probably don't even know it. Most people don't know this. Then you can enlighten them and say, “Yes. Your money doesn't have to be invested in mutual funds. Your IRA doesn't have to be in the stock market. Your IRA can be invested in my deal, and it's not withdrawing the money from your IRA. It’s just buying a different set. It's just a different widget in the bucket called an IRA or a solo 401(k), a self-directed account.”

[00:03:17] WS: That's good to know. I mean, even to be able to say that. It's not withdrawing the money from your IRA. I may know that, but I may not think to tell an investor that, just so to kind of ease that burden or that fear around there's going to be a penalty or there's going to be some – "I don't know if I want to take that money out. There's that fear that they may have they may not even know to ask.

[00:03:36] KH: You can't believe how prevalent that is. You're exactly right. So, when you transfer money from an IRA or rollover an old 401(k) or old 403(b), 457, an employer plan, when you're doing that, a custodian-to-custodian transfer isn't taxable. So, when the money rolls over into the self-directed IRA, not a taxable event. Then also when the IRA invests and the money goes out of the IRA, you're not pulling the money out personally, so you're not going to get a 1099 for investing. Therefore, it's not going to be taxable. Super important. Big misconception.

[00:04:06] WS: What about thrift savings plans?

[00:04:08] KH: Yeah. TSPs, sure. I mean, if you leave the service of your employer, yes, you can rollover TSP absolutely and use that. As long as they're qualified funds, meaning they're tax-protected, ERISA funds from an employer plan, IRA funds, then yes. You can self-direct that money.

[00:04:23] WS: Let's talk about that due diligence you were talking about a little bit for those other IRA holders. Walk us through some due diligence that we need to be aware of.

[00:04:29] KH: I'm going to talk about the basics, but I think it's worth it even for the most seasoned investor, because a lot of times we know everything, but we don't remember it all the time. We have big brains, but we can't remember everything all the time. I mean, first of, you have to do your due diligence if you're investing in a syndication. You want to talk to other people who've invested with that syndicator. Obviously, you want to read the entire operating agreement. You want to read the sub docs. You want to understand what's going on so that you understand the principles and who's involved, what's their track record. Google them. Comprehend everything you can.

If you're investing in real estate, just straight up in brick-and-mortar, then you want to do your due diligence by maybe getting a preliminary title report, looking at the property itself, really taking a look at the conditions, again figuring out if you're working with somebody. Google them. Find out about them. But what's really important with real estate too is making sure that your IRA's interest gets actually recorded, because you want to make sure that your IRA actually owns that asset after the money has been dispersed. So, we can disperse the money. But when it's a self-directed IRA, you're double-checking to make sure that your IRA's interest actually got recorded.

[00:05:33] WS: How do we check that?

[00:05:34] KH: You can check it with the County Recorder's office. Sometimes, you can just look it up online. Especially, you probably have an APN assessor's parcel number or something you can use to refer back to the property. Then I know that they don't always operate at lightning speed but once – You can always check with the County Recorder's office to make sure of that recording.

[00:05:52] WS: I know some investors that are listening are thinking, "Now, wait a minute. I live in New York, and the sponsor that I'm investing with is in Wyoming or somewhere else." So where would they be checking for that?

[00:06:03] KH: Well, online. I know that especially on the East Coast, a lot of times some of the county offices are actually in people's houses in some of those smaller areas. But I would go online. We're so lucky to be connected electronically. It's a lot different than it used to be. So that's what I would say. Go online. Make a phone call. Pick up the phone. Hey. Then get details, because you're right. Every county, and how many counties are there in America? A lot. So, every county is a little bit different, so check with – Call the county and see how you should check.

[00:06:28] WS: So, make sure your interest gets recorded when we're investing with our IRA. So, anything else that when we're investing with our IRA that we need to be thinking about when we're looking at a sponsor or a deal?

[00:06:39] KH: Yeah. A quick little story. We had someone who is just like this close to losing her money. She had gone to a seminar, and she had lost a lot of money in the recession. So, she was eager to build a backup for her retirement. So, she went to the seminar, and they said, "Hey! Well, why don't you make us a loan? You have $500,000 in your retirement account. Why don't you make us a $500,000 unsecured loan on real estate, and we'll pay you 15%?"

Well, she wasn't a sophisticated investor, and that sounded like a good idea to her. She was already to go. But then we took a look at it and said, "This deal is not administratively feasible.It just didn't look very good," because a couple of things. In this case, it was a syndication. So, when you're dealing with a syndication, the people offering the opportunity have to be registered with the SEC and the state, and that actual offering has to be registered with the SEC and the state. So, check with the SEC before you do a syndication deal. Are they actually registered?

Now, this investor didn't do that. Because if she had, she would have learned that the people she was about to give her half-million-dollar life savings to hAD been incarcerated by the SEC. He was in jail for two years for stealing money from people. So, gosh. On uDirect's website, on the right-hand side, we have a list of different places you can check for things like that, the SEC, FINRA, NASAA with an extra A, even AARP. All of these websites can help you check out these asset sponsors and weed out the bad actors.

[00:08:05] WS: That's some great info. A lot of people can talk the talk and really make you feel like they're very trustworthy. But if they've done no background checks. I like what you said earlier. Even just a simple Google search a lot of times will tell you. Even looking somebody up on Facebook can tell you a lot about somebody.

Now, is the deal administratively feasible and looking the operators and the deal making sure they've been registered. What else as far as when we're looking to invest with our IRA?

[00:08:30] KH: Part of the due diligence is when you look at a syndication in particular is a syndicator, the asset sponsor, are they taking on debt? Because if that syndicator is taking on debt, it could lead to the IRA actually being taxed. I mean, you don't want to have tax in your IRA. That's why you're investing with an IRA, so it can be tax-free or tax-deferred. But there's a tax called UDFI, unrelated debt-financed income tax. I'm not a tax expert, but here's where you can find information on it. It's IRS.gov, Publication 598. So again, IRS.gov, Publication 598 will talk about this tax.

But we have account holders that will be investing in syndications. The asset sponsor, the syndicators taking on debt as part of the deal. Then now, here comes a K-1 rolling through, and at the bottom it tells them that here's the tax that you owe. The IRA has to file a 990-T and pay that tax. So that comes as a very large surprise to syndication investors when nobody told them upfront. So, when it's a self-directed investment, you're held to the responsibility of being the expert in investing.

All of our companies we're administrative. We're not fiduciary. We're not selling you assets at all. So, you need to make sure you're the expert in it, and there you go. That's how that works.

[00:09:42] WS: Anyways around paying that tax? Or should we not use our IRA to invest and to keep paying that tax? Or what are people doing to minimize that tax?

[00:09:52] KH: Yeah. You can't really minimize it, but I think what you want to do is you want to talk. If your IRA is investing in the syndication, you want to make sure you ask the asset sponsor, "Hey! Are you taking on debt? What percentage is debt?" Because maybe your profits are going to far outweigh the risk of any debt. So, yeah. Okay, I'll pay a little debt. Pay a little tax, I mean. That's fine, because I'm going to get this big payoff, and it's totally worth it.

So, you have to pencil out the deal in advance, but the only way to avoid this kind of tax is for your IRA to invest – We're talking about syndications here. It's for the IRA to invest in a syndication that's not borrowing money, not taking on leverage at all.

[00:10:24] WS: That's not going to be many.

[00:10:26] KH: No. Or here is another way. Okay, I came up with one more. Don't invest in the syndication as an equity partner. Invest as a debt partner and lend your IRA money to the syndication. In that case, that tax won't apply. There is a way out.

[00:10:38] WS: How often does that happen? Or have you seen that?

[00:10:40] KH: We see it all the time, especially on tax. “What? What is this? What have I got?” When K-1s pop out and then there are a lot of questions. “What do I do? How does this work?” So, the account holder has their CPA file a 990-T and the IRA pays any tax that’s due.

[00:10:55] WS: So how long does the process take if I have an IRA and it's been sitting over here and this is the first time I've heard of this and it’s like, “Well, wait a minute. This is brand new, and this is great information.”? But there’s a deal that I want to invest in. How long does this take?

[00:11:08] KH: It’s a three-step process, essentially. The first step is to open an account. So once we get the documentation we need from you like the application and there’s $50 setup fee and we need a copy of your ID and so forth, we open it the same day. So, boom, your IRA is open. That's great.

Step two is funding that IRA. So, you can do that three ways. You can contribute. So, you to write a check out of your checkbook and put it in your IRA. That's one. Two is doing an IRA to IRA transfer, where the money is presently in an IRA. You fill out our transfer form. You sign it. Give it to us. We sign it. We send it to your current custodian like Fidelity or TD or whomever and then they move your money over. That's two. The third way to get money in your IRA is a rollover. So that's a previous employer plan. Like you said, TSP. Maybe it’s a 457, 403(b), 401(k), but the previous employer plan. Then you can roll it over. So, you open the account. Call that previous employer, “Hey! Here's my new account number. I’d like to roll my money into this account.” They’ll do that, but they’ll take about two weeks.

So opening is a day. Funding can be as long as two weeks, so plan for that. But while we’re waiting for the money to come in, we can be looking at your investment documentation, getting it all queued up. So, once the money hits, boom! You can invest, and we can send the money out, typically a 24 to 48-hour turnaround.

[00:12:24] WS: Any trouble with working with the current custodian, our previous custodian like trying to get the funds transferred and so?

[00:12:31] KH: Sometimes, you do run into trouble. Sometimes, they don't wish to relinquish the money. “Oops! We lost the form. You didn't do it right,” or they discourage you from moving the money by putting you through the ringer. Sometimes, you have to be determined to make it happen. But I think most of the custodians are straight up and will help you. I think self-directed IRAs are well-established in the public knowledge that these different custodians understand what it is, and they're pretty much all willing to cooperate. But you will occasionally run into one that’s going to stonewall you.

[00:13:00] WS: Are there any other questions that you hear from investors that maybe us as deal sponsors that you could help us be aware of or prepared to be able to answer?

[00:13:09] KH: It’s all about risk usually and if they’ve got questions that they’ll call me. They’ll say, “What is the return on a self-directed IRA?” It’s like, “No. You need to ask the asset sponsor.” So, I think people are extremely interested in the returns. They want to know when are they going to get paid back. It needs to really be laid out so clearly what the terms are for payback. So, pay what, “I just invested with you today. But wait a minute. It’s a month now. I haven't received any money. Where's my money?” It’s like, “No, because you're in this deal for a while. This is a fund. You’re probably not going to see anything in maybe a year.”

I invested in a private placement, and I kind of wrote it off, because I hadn’t earned anything in seven years, and all of a sudden here comes double my money back into the deal. So, it was a long-term hold in a eldercare facility. So, you don't know, but you need to talk to the asset sponsor and find out. It was not a large amount of money I would have been on the phone. But I just kind of wrote it off, and there you go. So, make sure that your investor is aware of the timeline for a return on investment.

[00:14:00] WS: No communication in seven years?

[00:14:02] KH: No. It was just crickets. Yeah.

[00:14:03] WS: That’s interesting in itself. You got to be communicating. I hope everybody that's listening as an operator is communicating with their investors.

[00:14:09] KH: If it was bigger, I probably would've been on the phone. But I had other fish to fry.

[00:14:14] WS: Yeah. Right. What about when we're investing, say, as a passive investor? I mean, anything else that I need to know about, I don't know, the IRA process or even working with you specifically that we hadn't talked about?

[00:14:25] KH: Well, I think when you're a self-directed IRA investor, you're not necessarily always passive. I mean, think about this, because it's self-directed. Maybe your IRA has lent money as like a note investment. Maybe your IRA lends money. It seems passive, because you're not out there swinging the hammers. But still, you need to be active with your self-directed IRA account, logging in, making sure funds got posted, making sure – Taking a look at your account. Does it look right? Check on it. Do you do due diligence with your own account?

We also provide a monthly statement. So, download your monthly statement. Save it on your computer. Don't wait. We have someone right now who had a fuss in 2012, and now she's trying to prove that she paid off a note in 2000. That her note was paid off in 2012. She never looked at her account. She never double-checked or anything. So, it's not passive with the self-directed IRA. You got a little bit of work to do. Not a lot but just make sure your money is there, and check it out.

[00:15:17] WS: Elaborate on the relationship between you as the custodian and the operator. Say, we're operating to deal. What does that look like communicating with you and when and how often?

[00:15:27] KH: Sure. So, you direct as an administrator. So, when you are working with us, then we use a trust company. So, there are different players in this game. So that's kind of setting the stage for how it works. How do you win again? You got to know who's playing the game. The asset sponsor is the person offering the opportunity. You find the opportunity in a self-directed IRA situation. So, it's self-directed. You found the opportunity. Bring it to us, and you tell us, "Hey! I'd like my IRA to invest in this deal." You fill out a direction of investment form. We call it a DOI. You fill it out. You tell us. Say, "Please, move my money."

Then we administrate it. We work with you and make sure everything is correct. Then we get – The money gets transferred out. Now, your IRA is invested in that deal. Then it's up to you to look at the terms of whatever that deal was, if it was a note, if it was a syndication, whatever it was. You need to be on top of it to make sure that the people that you gave money to are performing as agreed.

[00:16:20] WS: As the custodian, are you communicating at all with the deal sponsor or the operators of the deal, the syndicator? Or are you only communicating with the investor who's investing with?

[00:16:30] KH: uDirect communicates with its account holders. We communicate with our account holders. I mean, if the asset sponsor calls us and they have a question, we can answer if we have a third-party authorization on file from the account holder saying, "Yes, it's okay to talk with them." But we would never give information to anybody other than our account holder about an account without permission. So that's how that works. We're not going to reach out and call them without permission.

[00:16:53] WS: When distributions are made, they are – The distributions are made to you or to the investor?

[00:16:59] KH: They are never made to the investor. We had somebody make that mistake, and they paid these investors personally, and these people put the money in their account. Guess what that is? It's called the prohibited transaction. You know what that means? For self-directed IRA, it means game over. You are out. All the money – If it gets called as a prohibited transaction by the IRS, then what happens is your IRA ceases to be an IRA. That money goes to you. You get 1099 for everything. So never as an asset sponsor ever give the money to your investor directly if it's an IRA, always, always make the checks payable or send the wires to the IRA account. Incredibly important because you do not want to be the asset sponsor that causes your investor that much [inaudible 00:17:42].

[00:17:43] WS: It's good for the investor to know that as well, right?

[00:17:45] KH: Yeah.

[00:17:45] WS: Do not that cash that check if they do accidentally send you one.

[00:17:49] KH: We had this one investor, and he had a house in his IRA. So, the renters were paying him rent every month. He's just taking it and putting it in his pocket. He told us he was doing this, and we said, "No. You can't do that!" He says, "Oh! No. It's okay. I cleaned it when I filed my income taxes." It's not personal money. Your IRA is a bubble, and everything stays inside that little bubble. So never mix your personal money with IRA money.

[00:18:12] WS: I was just thinking though about that investor if they accidentally do get a check from the operator. They need to know that. So, if they don't cash that check though, it's okay like if they just ripped it up, they could fix it, right?

[00:18:21] KH: Yes.

[00:18:21] WS: Then they can fix it, right?

[00:18:23] KH: The investor should call the operator and say, "Hey! You sent me this check. Thank you. But this needs to be made payable to my IRA. Here's how you make it payable. Here's the address. If it's a wire, here's where you should be sending it." But if it's a check, absolutely do not cash that check.

[00:18:38] WS: What's the hardest part of this process or even for you as a custodian? What's been the hardest part?

[00:18:43] KH: Honestly, it's people not understanding self-directed IRA rules or what's involved in self-directed IRAs. Having the wrong expectations, thinking that services are provided that aren't provided. We just do much education online and in person on our website to help. Then when people call us and contact us, we send emails and talk to them and give them so much information. But people will misunderstand things like – For example, if your asset has a zero value, you need to understand that upfront about self-directed investing. Now, you've invested. Asset value is zero. We can't just write it off. We can't just say. "Oh! You told us it's zero. We're going to say zero." IRS doesn't let us do that. We have to have a third-party valuator. Come in and tell us.

So maybe an asset sponsor – I mean, it's happened once or twice where an asset sponsor stole money. We hate that. But if that happened, you actually have to go out and have a valuator prove that your asset is worthless. So, I know it's adding insult to injury, but we can't just write it off. And that's something that people don't understand upfront about self-directed IRAs. Incredibly important to have that correct expectation. But hopefully, you do your due diligence. You make great investments. And sometimes, even when you do all the due diligence in the world, you can't foresee a recession or something that could cause a catastrophic event in your investment. But if the asset value is zero, you can't just – it would make us a fiduciary if we valued the asset and we are not fiduciary, then with that word comes a cascade of responsibility.

So that is not a mantle that we wear. We're not the fiduciary. But a valuator is and they can give us a valuation.

[00:20:11] WS: What's a way that you have recently improved your business that we can apply to ours?

[00:20:15] KH: Always improving. I think my favorite improvement we've done is to add a portal on our website so that when people are sending us documentation, it's not going through email so that you can upload information through a SOC 2-compliant portal. Then we receive it on our end, and then it's treated in that way. When we send you confidential information, it'll also be encoded through the same again SOC 2-compliant portal so that you are getting this information in the safest way that we know how to send it to you.

[00:20:43] WS: What's the number one thing that's contributed to your success?

[00:20:46] KH: Just keep swimming. I think consistency being there. It's suit up and show up. It's not difficult. In networking, that's incredibly important. That's the been the groundwork for my success has been having a network of just the most amazing, amazing people. That has been it. But then you just suit up and show up every day and just keep moving forward in a positive direction.

[00:21:07] WS: And how do you like to give back?

[00:21:10] KH: In so many ways. I mean, giving back to the employees. We're limited by the IRS how much we can give back to our account holders to $10. So, a lot of times, we'll give a free book. So, there's that. But in the community, I volunteer for the Council on Aging –Southern California in helping seniors, and that's not something that the company benefits from. But I sure do, because it's a great feeling to help so many seniors that have nobody. To be able to help them is very gratifying and wonderful.

Also, I serve on the Board of Directors for the Retirement Industry Trust Association, as you mentioned. So, I give back to our industry by helping. In fact, we're having a conference coming up, and I'll be leading a panel discussion on cannabis investing and IRAs, which you cannot do. But there's something called the SAFE Act, and it's a banking act talking about maybe are we going to allow as in this country banking with cannabis deals. What's the horizon in case this all becomes federally legal and then it's a thing? So, I'll be leading a panel discussion on that. So, I give back to my industry.

[00:22:06] WS: Tell the listeners how they can get in touch with you.

[00:22:08] KH: The best way to get a hold of us is send us an email. info@udirectira.com. It's a letter U, udirectira.com. So that is the very best way. Look at our website too. It's udirectira.com. So much information. So much information there for you to learn about self-directed IRAs.

[00:22:27] WS: Thank you very much, Kaaren.

[00:22:29] KH: Thank you. That was fun.

[OUTRO]

[00:23:11] ANNOUNCER: Thank you for listening to The Real Estate Syndication Show, brought to you by Life Bridge Capital. Life Bridge Capital works with investors nationwide to invest in real estate while also donating 50% of its profits to assist parents who are committing to adoption. Life Bridge Capital, making a difference one investor and one child at a time. Connect online at www.LifeBridgeCapital.com for free material and videos to further your success.

[END]

