EPISODE 973

[INTRODUCTION]

0:00:00.0 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.

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Whitney Sewell

This is your daily real estate syndication show. We are introducing a new segment called The Real Estate Syndication Show Highlights, where we're bringing you a look back at episodes focused on a specific topic that we believe added value to you in your syndication journey.

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[INTERVIEW 1]

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Whitney Sewell

Our guest is Jonathan Feniak. Thanks for being on the show, Jonathan.

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Jonathan Feniak

Thank you very much for having me.

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WS: Yeah, honored to have you on the show. A very important topic for anyone that's in our business, especially if you are investing passively. But a little about Jonathan. He's a general counsel for Cloud Peak Law and a partner at its subsidiary, Colorado Trust and LLC attorney. Prior to becoming an attorney, he worked with sophisticated investors in high net worth individuals at hedge funds and as a financial advisor. Now he assists investors and implementing asset protection and privacy enhancing structures.

Jonathan, welcome to the show. As I said before, very important topic. And I've heard different methods about this, different thoughts behind it, but probably not often enough. And I think many investors are investing long before they ever really think about the long-term implications of not having some type of asset protection plan. Then all of a sudden, you know, they think about what about privacy? And it's not something you know… We've probably spent enough time educating about before we get into this business. So, welcome to the show. Give us a little about, you know, the asset protection stuff that, you know, you're working on now and let's dive in in helping that passive investor that's listening.

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JF: Yeah. well thank you for having me again. One of the things we like to think about with asset protection and privacy is, what are your attack surfaces? And this is something I've gotten from my friends and colleagues who were in the cybersecurity space. And they think about what is the potential weakness in the structure you have created? And there's likely, when you're first starting out, there's a lot of them. People will know who you are. They'll know you own these properties because your name will be listed in the title records if you're purchasing properties as an individual. They will see your name there. If you're forming LLCs, just going through the Secretary of State's site, perhaps you're acting as your own registered agent and your information becomes available there, you're potentially putting information about yourself in on social media or putting information about yourself on LinkedIn, on your website on podcasts like this. And each of those represents a potential attack surface for you.

Now the thing to think about is, you know, I mean, people know who you are, there's absolutely a lot of benefits to that. But having people know what you own is potentially something that could be disruptive in your life. You know, I think about over the course of someone's life, what could potentially go wrong? And we see well COVID it happened, right? That happened, you know, this year over the last year. Oh, and the 2008 financial crisis. We had the 2000 financial crisis. We had many… You know, the savings and loan crisis before that. Every decade or so there's another crisis that could potentially bring on you some sort of financial hardship. You know, we call these credit events.

Now there's external credit events, and then there's internal credit events. And internal credit events would be something like you own a piece of property, someone slips and falls and hurts themselves and hurts themselves badly. A credit event could be you getting in a car accident, you're totally at fault, and you've harmed someone. Each of these things is also something that could disrupt your overall plan if you haven't focused on asset protection and privacy from the start. I heard some of your other guests talk about if something happens, can they find out what you're worth? Are you a good target for a plaintiff's attorney? And by practicing privacy right from the start, and then implementing asset protection structures behind that, you're going to be less of a target. When one of these things, which is almost guaranteed to happen, happens.

Hope is not a plan. That will be sort of something we talked to our clients about all the time. Getting something in place even if you're a little bit further down the road. If you haven't done things right from the start, it's not too late.

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WS: That's good to know right there, that it's not too late. And so, let's talk a little bit about… or maybe you can like walk through a typical structure for somebody that's looking to invest in real estate syndications or something like that that, you know, they want the privacy, they want the asset protection. What is it? And sometimes, I think, people just don't because it seems a little bit overwhelming and I gotta be, "Okay, you know, that's not going to happen to me." Right? But, you know, what's a typical structure that you would lay out for someone? Or some things they need to be thinking about as they're planning to invest?

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JF: Yeah. Well, syndications are interesting in that, you know, you don't have a lot of that if somebody slips and falls at the property that you're an investor. Syndication probably not going to come after you as an individual. It's highly unlikely that they would, but I've had clients who wind up being co-investors on deals, syndication deals, with people who were really not people they wanted to be associated with. So, let's imagine you were a co-investor on a deal as a limited partner with Jeffrey Epstein. Okay? You now are seen in the public's eyes being your partner, and you are a partner with Jeffrey Epstein. Pick someone else, you know, who's unsavory or has done absolutely terrible things in the public space. Your name would potentially be released right alongside that terrible person's name. That right there is a reason to not be investing in limited partnerships without having it through an entity of some sort. Do it through an anonymous trust.

Do it through a limited liability company which is formed anonymously in one of the states which allows it. And we can sort of talk about that. There's about four states that allow for anonymous LLC.

We've actually begun to offer anonymous LLC filings in every state doing it. We are your attorney and so we will form that entity in any state for you, but just as a limited partner. It's critically important to maintain your privacy. If all you're investing in is limited partnerships, that may be enough because there isn't a lot of….there is a financial downside on those deals. But you are limited. If you have a… Either you're a sponsor of it, you're the general partner of the deal, you're putting it together. You may have much greater liability in that transaction. If you are purchasing properties, outright purchasing them to rent, to buy and hold, or fix and flips, you have a significant amount of liability that would go beyond just investing as in an LLC. You know, we view that sort of the basic structure as six different things you do to protect yourself when it comes to asset protection and privacy. And number one, I used to be insurance licensed when I was a financial advisor. Having good liability insurance, you know, whether if you're sponsoring an offering, then doing it as having a director and officer or, you know, insurance in place. Things may happen if you're renting property out, if you're owning and renting property, then having liability policy landlord tenant policy in place, huge first step because 95% of the time that's going to satisfy any potential plaintiffs and plaintiffs attorneys. Beyond that, investing in liability producing assets through a limited liability company.

Now just having an LLC is often not enough. Many states have fairly weak Limited Liability Company laws which will allow for something called veil piercing. I'm sure people have talked about this on your podcast before. How do you avoid veil piercing? Every state's a little bit different, but number one is, well, there's no fraud being perpetrated by the Limited Liability Company. And then, is it your alter ego? So do you have a separate bank account for it? Do you have separate books and records for it? And you have to think about these things. You need to go before a judge and convince the judge that this entity is separate and distinct from you. How are you going to prove that?

That's one of the approaches we like to use is thinking about the situation where you're in front of a judge and you're in front of a jury established that you're not the same as this LLC. Then thinking about anonymity. What is it, or what information of yours is going into the public record? Some people try to save a little bit of money. They don't hire a Registered Agent. They don't hire someone to form their LLC for them. Well, they are then in the Secretary of State website and that will be there forever. We form… Wyoming and New Mexico and Delaware are three states in which we have operations and we can form, private, LLCs for you there. So our name goes into the Secretary of State's records is organizer. And then once you have one of those entities setup, you can then form a subsidiary in any of the 50 states that will also be private. So, we will have listed as the member of your, say Tennessee LLC, list the Wyoming or New Mexico, or Delaware entity as the parent company. This way your name stays out of those Secretary of State records. We do that frequently for our clients.

Another thing that we do for our clients, which I don't know that there's sort of firms of our scale which are doing it, but we offer nominee services. So, a simple document, a deed. It's going to go into the public record that will attach… will go into the chain of title and it will attach your company to a particular piece of property. We will sign as a nominee manager for your entity. We could sign as a nominee manager for your limited partnership investments and I call it sign and resign. You know we have an agreement which lays out what our responsibilities are. But we will serve in a role as a manager of your company for just that single transaction, sign the documents, our name, one of our team's names goes into the public record. And all that's going to be there as well, it's this LLC, this person acted as the manager at this particular point in time, but it's not connecting back to you. So, you got those sorts of the three foundational topics there, you know.

And then another thing… and listening to to a number of your guests, you know, you talk about mezz debt. And you talk about preferred. And there's a lot of investors who don't like to use that and I totally get it. They like to, even though it diminishes the returns, just the idea of having debt on the properties upsets them.

[INTERVIEW 2]

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Whitney Sewell

Our guest is David Disraeli. Thanks for being on the show, David.

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David Disraeli

Thanks for having me. I appreciate it.

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WS: David is an entity formation expert who is going to explain how to obtain total anonymity. Is that how you say it, David?

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DD: Anonymity and privacy.

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WS: I can't even say that word for some reason. Anyway, it always trips me up but asset protection, using his FlexTrust LLC concept that he developed. David works primarily with real estate investors, brokers, and developers to create customized structures and processes to build and protect wealth. He has over 34 years of experience, and I'm just really looking forward to this conversation. I know this is – It's a very important topic and I feel like it's probably not talked about enough for a lot of people who wait too late in the game to figure out that they should've been thinking about some structuring and what their business looks like long before they do.

But, David, welcome again to the show. Grateful for your time. Give us a little more of your background and your superpower here in the business, and let's dive in.

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DD: Sounds good. I started out 34 years ago in the brokerage business selling securities, insurance, doing financial planning. I migrated over to portfolio management. While I did that, I formed a couple startups and ran those simultaneously and developed a fair amount of business experience and came face-to-face with the whole idea of exposure and risk. That sort of changed. I guess you could call it a pivot point in my career so that when I met clients on the financial advice side, I'm looking for threats. Whether you work for a company and just have a large net worth or you own a construction company where fingers and toes and arms can go missing, everybody has the exposure.

Growing and maintaining wealth and not losing it to some stranger that walks in your business go hand in hand, and that's why I've had this whole asset protection mindset at least for the last 15 years, and I've just continued to hone my skills and to help everybody. Whether they came to me for one product or a different product, I'm always thinking about risk and how to protect it. Now, people, of course, are finding me online, specifically because they want asset protection or they own properties in their own name and they recognize that's not a good idea.

In the last year or so, I've been on BiggerPockets and reading about more complex concerns around privacy. Even if you have properties protected in an LLC, it doesn't take a lot of effort for somebody to get online and find out everything you own, where you live, your net worth in a matter of 15 or 20 minutes. That disturbs a lot of my clients and that led me to develop the FlexTrust LLC, which in simple terms is merging two different concepts. One is a revocable living trust which has been around for, I guess 200 years in the United States and before that in England and the LLC concept.

By merging the two, you can create an LLC in Texas and I'm sure other places as well where nobody can ever determine who you are, and that's important for a couple reasons: One, if you were out driving around and got in a car wreck and somebody got interested in coming after you, they can go online and find out that you've got 5 or 10 properties and where you live.

With this structure, they can Google until their fingers fall off and they will not find you. The other side of that is if you have a problem associated with one of your investments. It could be an investor. It could be a tenant. It could be somebody mowing the yard. It makes it that much more difficult for them to assess just how attractive a target you are. Or you might just want privacy.

Believe it or not, if you type in Michael Dell into our local appraisal district, you'll find out that he has a $30 million house in plain view. To me, that's just crazy. Why would somebody that's known all over the world let the public know where he lives and how much his house is worth. There's mechanisms, fortunately, in place that suppress that information. Not that it's impossible but the idea is to make it as difficult as possible for someone to ascertain what businesses you own or control, what real estate you own and control, and therefore make you less likely to be a target.

Of course, if you have the right structure in place, the LLC provides almost complete asset protection anyway, assuming it's set up correctly. That's a big assumption. But if it's set up correctly and the LLC is sued, they can't come after the individual owners. They can only go after the assets in the LLC, which is very difficult to go and grab assets and pull them out, especially if there is mortgages on them. It can be done, but at least they can't come after your other personal assets, cash, brokerage accounts, and stuff like that. The LLC has helped I guess put a gate around your other assets.

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WS: Sure. Well, David, a lot of the listeners are operators, so they're doing deals or their passive investors and somebody who already has – Could you just walk us through a little bit I guess of creating something like this? Let's say, if we already have, let's say, numerous entities and already have numerous properties in different entities, how do we then say, "Okay. David, this FlexTrust things sounds pretty good. How do we implement something like that and really have that privacy like you're talking about?"

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DD: That's a great question, Whitney. I'm glad you asked it because as useful as it is, if you've already got LLCs in place or even a whole entire estate structure in place with all the different documents, you might be reluctant to go back and start over because you name I already out there.

So, there's two different approaches to implementing this. One is to stop buying things in your LLC and start a brand new one. Keep what you have and start a brand new one because even if we change the ownership of an LLC from an individual to a trust, all you have to do is pull the original formation document and find out who that person was anyway. The only way this really works completely is to form a brand new one in the name of the trust where the individuals' names are never disclosed.

The two approaches would be from this day forward I'm going to do it using all the different privacy features available or you could – It's really not that difficult to do a text because we have something called a series LLC where you can have 10 or 20 different properties or more, and really there's no limit in one LLC. But for legal purposes, they're all in legally distinct silos or series. I think 14, 15 states now offer that. Texas is one of them, so you can start a brand-new series LLC using the trust as the only member and move all of your existing properties into that LLC. The only way somebody will know what happened with those particular properties is to go to the actual deed records and see that John Jones LLC deeded it over to a different LLC. When they find out who owns it, which is a trust, they're pretty at a loss at that point. They can only assume it's the same person but they have no way of really knowing that.

Now, any future properties won't have a paper trail at all because they were actually transferred or purchased by the brand-new LLC that has no history at all, so the two approaches are too, from this day forward, do it differently or go back and retitle everything. It just depends on the person's risk tolerance and their attitude towards it as to which one because one is going to be more expensive than the other.

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WS: We need the FlexTrust first ultimately. Then we would title any new entities under that FlexTrust. Is that correct?

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DD: There is – By the way, I made up the word FlexTrust. There is no such thing. It's really a revocable trust that is not identifying who – Like a lot of people put the John and Mary Jones living trust because they're trying to avoid probate. That's their main goal. That doesn't hide anything because the John and Mary Jones Trust is owned by or operated by John and Mary Jones. What my clients do is they just make up a name, and there's no way to find out who they are because the trust is never filed anywhere. That's true in every state in the country. They're private documents. There's no probate. Even when they die, that document does not have to be submitted to a probate court, so it's always going to be at a public records.

But, yes, you have to start with the trust and then you can form entities underneath it, you're your house over to it or whatever you want to do. But the FlexTrust is really just a way of saying this is the most flexible type of trust on the planet. It's designed that way and it operates that way, so I named it the FlexTrust.

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WS: I've heard a lot of people say you need a living trust for the probate issues and things like that. Would this serve that same purpose?

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DD: Absolutely. Yes, it would. In Texas, we don't have a super difficult probate system that can be navigated by a relatively intelligent businessperson. They don't have to hire an attorney. But any time you invoke the probate laws even with a perfectly executed will, you're still committing yourself to some administrative overhead, time and money, and public disclosure of who you are and who got what. A lot of people don't like that. A probate is not a huge problem here like it is in California where people in their 30s are forming living trusts because they just hate the idea of having to go through probate.

In Texas, it's a little bit easier to streamline but the living trust avoids it altogether. The second part of that is if you probate a will and put people on notice, which you're required to do, there's a 60-day waiting period where disinherited heirs, love child relationships, or love children whatever you want to call them can show up and say, "Hey! Daddy or grandpa was supposed to have included me and apparently, he didn't," and they can apply to the court to challenge the will. With a living trust, the transfer from one generation to the next is seamless, instantaneous. Just like a life insurance policy or an IRA, it gets paid out directly to the beneficiary without any court action at all. It's literally I would say impossible to challenge a living trust. But since the assets have already been transferred, the challenge would be against those beneficiaries and no attorney is going to take that case without a $30,000 retainer, and the odds of winning are very remote.

What happens in probate as you go and make enough fuss, the other beneficiaries say, "What is it you want to get you out of my life?" They settle because it can drag on for months or years. Now, living trust doesn't work that way. It's instant, so it's after the fact that a disgruntled heir, a disinherited heir or whomever says, "Hey, I want to make a claim." Now, they have to just basically file a lawsuit against the beneficiary. They can't use the probate court because it's not even in the probate court. It's just a private cause of action just like any other lawsuit. The living trust performs those two vital functions. One is avoiding probate at all or any kind public disclosure of what you left, and it helps minimize the chances of somebody could actually challenge it in.

Having been doing this as long as I have, I've seen the worst in people, and it's always blood relatives that fight with each other. It's awful to watch and to hear and to see and is avoidable. Whenever I've talk to a new client right now, one of the first things I do is I put on my social worker hat, which I have no training in by the way, and ask, "Hey, tell me about the family."

They'll tell you, "Well, we've got two kids that are married and stable and one that's a problem child," or, "All three are great," or, "All four are bad." I had one client tell me that there wasn't a – He had four siblings because I was asking who could be your executor. He said none of them. They're all either – They've got health challenges, mental challenges, alcohol challenges or they haven't spoken in 20 years, so we had to hire a bank to do it. That happens too. Some of the worst disputes in the whole entire country are between blood relatives, and it's really sad.

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