

PENSCO Wednesday Webinar Series

Five Reasons to Buy Rental Property Now with Your IRA & How to Handle "Hard-to-Value" Assets

Wednesday, March 3, 2010

11 am PDT / 12 pm MDT / 1 pm CST / 2 pm EDT

Hosted By:

Tom Anderson, CEO & Founder, PENSCO Trust Company
Robyn Levin, Founder/President of R. Levin Marketing Group

Guest Speaker:

Roger St.Pierre, Senior VP, First Western Federal Savings Bank

Information presented is for educational purposes only and is not intended as, and may not be relied upon as, tax, legal, investment or other advice. You are advised to consult your advisors for specific guidance regarding your investments.



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6 Reasons to Tap Retirement Funds Now to Buy Real Estate

1. Tangible Asset - you can see, touch, and feel
2. Real Asset Diversification
3. Many Choices in today's marketplace
4. Affordable Prices
5. Better Cash Flow
6. Upside Capital Appreciation



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Look Under the Covers

(Do your due diligence)

- Just because prices are lower, that doesn't necessarily mean it is a "good deal"
- Eyes wide open
- Make sure you are getting what you think you are getting



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HOA's Home Owner Associations

- Get 2 years financials
- Look at legal expenses
- Look at lien expenses
- Special assessments-Why?
- Maintenance and repairs
- Reserves



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Target

- Diverse economy
- Short commutes to job centers
- Close to shopping, restaurants, services, schools
- Favorable rents versus purchase price



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Where are the Deals?

Phoenix, Arizona

- Prices have dropped
- Rents versus purchase price positive
- Low insurance cost
- Low taxes
- Low maintenance

Texas



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The IRA, The IRS & UBIT



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UBIT - Unrelated Business Income Tax

- UBIT is a unique tax originally created by congress to apply to tax-exempt entities such as churches, charities, and universities
- Congress was concerned about active businesses being operated by exempt organizations and paying no income tax
- The purpose was to alleviate unfair competition by exempt organizations with taxable enterprises
- For purposes of the tax code, IRAs are considered trusts



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UBIT

- Based upon average indebtedness over the course of the year
- Less debt = less UBIT
- Trust tax rates
- File IRS form 990-T



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Example - UBIT

- 50% (\$250,000) loan on \$500,000 commercial building
- UBIT means 50% of the net profit is subject to UBIT
- If net profit was \$40,000 then \$20,000 is subject to UBIT
- UBIT is filed on IRS form 990-T
- Is not reported on personal tax return



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What is a Non-Recourse Loan?

A non-recourse loan is a loan secured entirely by the collateral

Upon default, there is no recourse to collect the loan from the IRA owner personally or the IRA itself



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4 Main Issues

1. Does the IRA have the funds?

40-50% down

Closing costs

10-15% reserves

2. Debt Service Coverage 1.2 or greater (unless flipping)

3. Is the property a good one?

4. Does the transaction make sense?



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Debt Service Coverage Ratio

Purchase Price \$100,000

Loan Amount \$50,000

Gross Rental Income	\$12,000
Less Vacancy (7%)	\$840
Taxes	\$1400
Insurance	\$600
Maintenance	\$600
HOA	\$0
Utilities	\$0
Mgmt (10%)	<u>\$1200</u>
Net Operating Income	\$7360
Annual Debt Service	\$4093
DSCR $\$7360/\$4093=$	1.80



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Properties We Lend On

Residential (single family, multi-family, apartments)

Commercial

Farms with income (rental income or CRP income)



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Next Month's Wednesday Webinar:

Beyond the Investment: How to Ensure Financial Oversight

- * What Your CPA Should Know About Alternative Investments
- * A Checklist for You & Your CPA

Wednesday, April 7th, 2010

As a past participant, you will not need to register again. We will send you a reminder email with the call-in information and a link to the handouts.

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Sample topics:

- Strategies and Scenarios for Self-directed Investing
- How to Attract More Clients Using Social Media & PR
- Creative Applications for the Roth IRA Conversion
- How to Legally Promote Your Private Placement

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How to value Hard-to-value assets

Tom W. Anderson
Vice-Chairman and Founder
PENSCO Trust Company

Self-directed Custodial rules for asset valuations

- Industry parity growing on treatment of asset valuations
- Annual IRS requirements for custodians
- Rational for IRS requirements
- Current accepted industry practices

Governmental concern over valuations

- **Post Madoff era**
- **Transparency**
- **Accountability**
- **Accuracy**
- **Timeliness**
- **Roth IRA conversions**

Self-Directed Industry Direction

- **Petitioned the IRS**
- **General recommended approach based on:**
 - **Practical cost/benefit to investor and**
 - **Dual need to satisfy the tax treatment for distributions**

Impact of change in approach to investors

- Approach to taxable event scenarios is going to be handled consistently (if not already) across all self-directed custodians;
- All situations involving taxable events (e.g., distribution or conversion of a hard-to-value asset) will require a qualified third party appraisal
- Non-taxable event or requirements to be handled generally (although not as consistently) on best efforts” basis.

Objectives of Custodians when reporting and obtaining valuations

- To properly reflect the current value of their clients' retirement accounts
- To avoid overcharging client fees
- To satisfy regulatory requirements

Valuation Challenges

- Sponsors of illiquid assets not always cooperative due to the time and expense of obtaining fair market valuations of their investment offerings
- The practical difficulty of estimating value of certain assets where there is no public market and/or tangible basis for valuation
- The difficulty of obtaining values close to year-end as required
- **Processing Required Minimum Distributions**

How to Handle capital calls

- Avoid having a collective interest (including the interests of related parties) equal to 50% or more;
- Input capital on a prorated basis;
- If your interest is greater than 50% through your IRA, you may only invest personal funds to respond to capital calls;
- Alternatively, you may make a personal loan to the entity following DOL Exemption 80-26

Documentation Requirements

- **Annually when a distribution is involved:**
 - Independent appraisal from a qualified third party (note: custodian may challenge any appraisal that does not appear reasonable)
- **Annually when no distribution is involved:**
 - Independent estimate of fair market value from asset sponsor or other independent (e.g., a comp by a realtor for a real estate assets or an estimate from a CPA for an LLC investment)

Future of Hard-to-value asset valuations

- Debate involves SEC, DOL, FASB, IRS, self-directed financial institutions and investors
- Natural conflict between the theory and the practical reality
- Increasing pressure to perfect the process and to increase accountability for the purpose of protecting the consumer which is likely over time to require more diligent efforts on the part of custodians to obtain fair market values

Thank You!

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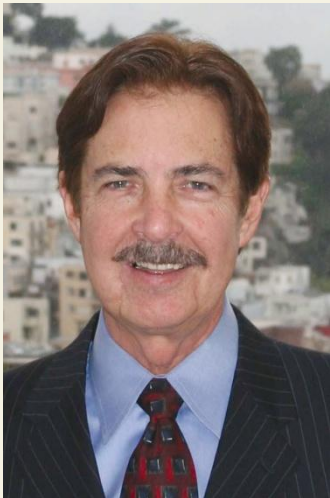
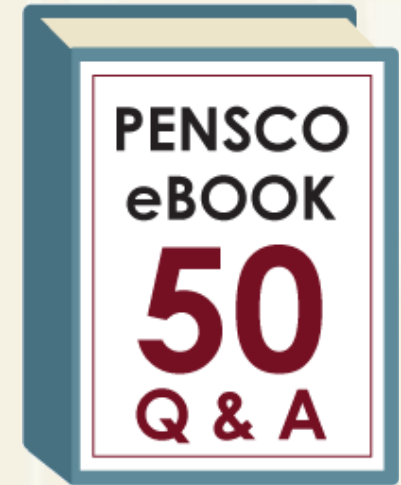
Listen to recordings and download the corresponding presentations by going to:

www.penscotrust.com/education/webandaudioconferences.asp

Other Resources:

**Get the Answers to Investors Top 50
Questions on Investing with a Self Directed IRA!**
Download by going to this link:

www.penscotrust.com/education/pdfs/ebookweb.pdf



**Get the Latest Information in the
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Go to: www.selfdirectedira.com

**An educational blog by Tom Anderson,
Founder, CEO, & President of PENSCO Trust**

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