

“My IRA is up 22% in 2008, how about yours?”

Smart Investors Vote with Their Feet and Funds

By Andrew Waite

“For 2008, my IRA is up 22 percent*. How about yours?”

As the bumper sticker says, “If you’re not outraged, you’re not listening.”

For years, Bear Stearns, Lehman Brothers, and Merrill Lynch were the leading financial managers for American wealth. Wachovia and Washington Mutual were among the top ten banks.

They have managed their own assets so badly that they have essentially gone out of business or sold out at pennies in the dollar. What is an average investor to do?

VOTING WITH THEIR FEET & FUNDS

Tom Anderson, president of PENSICO Trust, has noticed something very interesting. Business is up in the midst of this calamity. For the first time, people are taking entire accounts out of the traded asset market and moving them to self-directed individual retirement accounts.

“Normally we get IRA set-up checks in round numbers like \$200,000, as IRA owners test reallocating funds to self-directed IRAs,” says Anderson. “Investors begin balancing assets and buying ‘non-traditional’ assets like real estate. In the last month, we have seen more and bigger checks with odd numbers like \$617,344.92.” IRA owners are losing trust in “conventional” financial

advice. They are closing their traded asset-based stock, and their fund and bond IRAs accounts, and moving them to self-directed investments.

HANDS-FREE REAL ESTATE HANDS DOWN

Boomers have awakened late on the lifetime wealth generation curve to discover that their remaining investing life is uncomfortably short. The simple compounding of investment savings cannot accelerate the necessary wealth accumulation in the time left.

Wise real estate investment beats everything short of “holding up a bank.” For paper assets to get returns anywhere near what Wall Street economists and commentators claim, they have to include capitalization rates,



and omit leverage, utility, and tax advantages. An investment in real estate brings a fungible asset with leverage-able security and real income versus tattered Lehman Brothers or AIG paper. Comparison game over!

GOOSE EGG OR NEST EGG?

Wall Street laid another goose egg while entrusted with the nations' nest egg. This time the "investment wizards" screwed up to the tune of trillions! They proved they cannot be trusted to manage in a complex environment, as each decade of new money managers forgets the lessons of the past. You simply cannot defy economic gravity. For a dry but hilarious background in the generational follies of Wall Street financial risk management, read Richard Bookstaber's "A Demon of our Own Design," John Wiley 2007.

This time they are trying to blame the housing market. The mortgage-backed securities disaster is a result of Wall Street's desire to control securities related to housing. After failing at their perennial attempts to take over Fannie Mae and Freddie Mac, they created their own secondary mortgage market. They went wild detaching title and security from real estate loans, commoditizing and derivatizing this paper by dicing each mortgage (pool) up to five ways with separates rights to servicing, principal, interest, long- and short-term risks. Wall Street sliced the paper to the point of near worthlessness at current mark to market pricing, while reaping huge fees and profits. Mortgage-backed securities were always paper, never houses, and far removed from the security of a title, no matter how hard these sellers sold.

INVESTMENT STATEMENT GUT CHECK?

The retirement and financial management industry has an estimated \$18 trillion of America's IRA assets under management. The bulk of these traded assets (stocks, bonds, money market, and mutual fund shares) have under-

gone massive write-downs. Shares have lost significant value. Wall Street Brahmin Lehman Brothers has gone to zero. Traditional IRA and investment account owners can expect a nauseating gut check with their next statements.

Yet those accounts that manage nest egg, education and family assets in a self-directed IRA have not seen similar write-downs because they are not heavy with securities. Kevin Stunek of Entrust says, "My self-directed IRA is up 22 percent in 2008." In fact, well-bought income real estate in SDIRAs has continued to throw off cash even if real estate appreciation has paused. SDIRAs are long-term holds.

SELF-INTEREST & SELF-DIRECTION

Big securities-centric firms discourage SDIRAs by omission because money in non-traded assets, such as real estate and family businesses, do not earn fees or commissions for securities-centric money managers.

The average investor is at a serious disadvantage on Wall Street. When an investor like Warren Buffet advocates understanding what you invest in, leading to greater control of self-interest, we listen. Buffet's classic advice, "Don't invest in stuff you don't understand," takes on renewed importance.

Beyond tax advantages, SDIRAs free investors to invest in what they understand. Now add to SDIRAs other self-directed models, like the Safe Harbor© from the LASAII division of Uranga & Associates, that enable even more control and immediate benefit. Here you can buy investments that are more understandable to the individual investor than any Wall Street instrument: real estate, private placements, personal loans or the family business.

CAN YOU LIE ON YOUR BEACH?

We personally use SDIRA strategies to defer taxes and thereby build nest eggs or retirement assets faster. The inevitable tax bite is deferred to a future when taxes are — theoretically — lower.

The IRS Code defines what a SDIRA *cannot* invest in; including collectables (gems, jewelry, antiques and automobiles) and insurance products. Everything else is acceptable.

There must be clear separation from the asset and the ultimate beneficiary to avoid violating the legal spirit of the tax deferral. There can be no commingling of personal and IRA derived finances to support the SDIRA-owned property. These rules are well established.

However, the Safe Harbor© method we recently discovered offers a different approach to an IRA holding non-traded assets that allows use by the beneficiary.

"Can you lie on your beach?" asks Alberto Uranga of LASAII, a division of Uranga & Associates. "The Safe Harbor© method allows enjoyment along with the tax deferred investment."

The SDIRA property cannot be used in any way to benefit the SDIRA owner. The regulations allowing these methods of self-directed investing are neither new nor controversial but they need expert legal, planning, and custodial services to ensure adherence to the rules of separation. Flaunting the rules could throw the IRA assets into a prematurely taxable state.

SAFE HARBOR© ALTERNATIVE

The Safe Harbor© method, as described by originator Uranga & Associates, uses a combination of careful structuring, estate planning (if applicable), IRA distribution rules, and the tax code to allow the owner to buy assets like real estate, then debt service and improve a property that the account owner may occupy or use as a vacation property. This is done by taking any required payments out of the IRA as taxable distributions. This method avoids many of the inconveniences of maintaining an arms length relationship with SDIRA held assets. Uranga says, "This is not for everyone, but when it fits specific client financial conditions, it is the best of both worlds, offering immediate benefit

with wise tax deferral.” SDIRA and the Safe Harbor© model have undergone legal challenges or audit scrutiny from the IRS and are deemed to be in compliance because they do not contravene the rules or spirit of IRA investment tax deferral.

Uranga & Associates specializes in this structuring and use a consultative approach. Most SDIRA custodi-

ans limit their services to the custody, administration and tax reporting. Both groups advise due diligence.

WHO BETTER TO CARE?

The critical component in setting up a SDIRA and Safe Harbor© structure is good advice. Few tax accountants or financial advisors are equipped to do this.

(Editors Note: Unless you are using a professional who is intimately acquainted with the law, and practice surrounding SDIRA and Safe Harbor© methods, do not expect useful advice.)

Professionals who know how to set up and maintain SDIRAs are rare. Those who do know are in demand. Following is a short list of specialists we know: Entrust, Equity Trust,

Benefits	Self-Directed IRA Inside the IRA	Safe Harbor® Outside™ the IRA
1. You select property	Your trustee will purchase it for you.	You purchase the real estate.
2. Transaction administration?	Trustee administers all transactions. (Fees will apply.)	Safe Harbor® in place to purchase real estate. (No fees after first transaction.)
3. Title held by?	IRA entity held by trustee.	Can hold title personally.
4. Trustee management and maintenance fees?	Trustee management and maintenance fees apply.	Not mandatory.
5. Can owner occupy or use?	Prohibited use by you, your family or business associates.	No restrictions on occupancy.
6. Prohibited transactions?	IRA arms length and “family transactions” prohibited.	No prohibited transactions.
7. Intrinsic value?	Not available.	Yes, as personal and business use allowed.
8. Property mortgage eligibility?	Restricted to “non-recourse” loans.	Traditional leverage and loan products may be used.
9. Non-recourse loans?	Few lending institutions and tight limits on loan amount.	Wide range of lending institutions to choose from and flexibility in loan amount.
10. UBIT tax exposure?	UBIT taxes could apply when IRA is leveraged.	No UBIT tax.
11. Mix IRA and non-IRA money to pay for improvements and expenses?	No, Only IRA monies may be used.	Yes, may be commingled for improvements and expenses.
12. Up to 155% penalty to IRA account value for self-dealing or prohibited transaction?	Potential penalties apply.	Self-dealing and prohibited transactions do not apply.
13. Mandatory distribution under RMD rules?	Could force the sale of property.	Does not force the sale of property.
14. Depreciation allowed?	No depreciation allowed.	Recapture tax upon sale unless 1031 Exchange is applied. Depreciation can be used. Recapture tax does not apply to heirs.
15. Tax offsets allowed?	No tax offsets allowed.	All tax offsets allowed.
16. Revenue and profit goes to?	IRA	You
17. Deferred tax?	Yes Full market value eventually taxed at IRA holder’s highest tax bracket.	Income taxable as net un-earned income. Profit from sale taxed as capital gain or 1031 exchange. Primary home \$250,000 per person tax exempt when occupied for 2 of last 5 years.
18. Tax on heirs?	Heirs taxed up to 70% on zero cost basis of the full market value of the real estate.	Heirs will receive real estate on a step up in basis tax savings.

Courtesy Uranga & Associates

PENSCO Trust, Trust Administration Services, and Uranga & Associates.

Entrust — Keith Stunek, director of training at Entrust Administration is his own best example when he says, “Year to date (2008) my SDIRA holdings are up 22 percent.”

“Wall Street has done a great marketing job. When people think of self-directed control they have been subtly limited to defining this as a selection of (fund) alternatives as offered by your company retirement plan. This is a self-directed illusion. Invest in what you know best. We recently spoke to 3,000 real estate agents at a National Association of Realtors conference and asked how many had IRAs. Almost 100 percent answered yes, but when asked how many included real estate in their plans, most had little or none. Investing in what you know is a great place to start,” says Stunek.

Hugh Bromma, Entrust CEO says, “Any market is a good market for people who know what they are doing and now is especially good time. Go local, national or international to spread risk, and then choose a custodian who knows how to do this.”

Equity Trust — Equity Trust is a division of a company with securities brokerage licenses that realized real estate and non-traditional investments (family businesses and private placements) offer additional security and leverage. Rather than lose business to some unknown investment management competitor, they decided to open SDIRA custodial services for clients, said vice president Rich Desich.

“The SDIRA rules are very settled and this is our preference. We are aware of the alternate methods but it is not our business to play ‘cat and mouse’ with tax regulators on other plans as we are a conservative company. The current market conditions clearly favor well-bought, leveraged, income producing real estate that can add to a successful SDIRA portfolio,” said Desich.

PENSCO Trust — Tom Anderson, president of PENSCO and SDIRA

thought leader, finds the Safe Harbor© approach as anecdotally legal but questions whether distributing and paying tax (which is not ideal for Roth IRAs), thus reducing retirement account and principal, is a good idea. “But then there are counter benefits of offsetting taxes on interest as primary or vacation residence, says Anderson.

Anderson stresses that money is safer at PENSCO because they are not a depository entity; they spread deposits with selected banks that they monitor daily, verifying reserves and FDIC status. PENSCO places great weight in knowledge, service levels, and professional integrity by doing the right thing for clients. When they make that rare mistake, it is rectified in the client’s favor.

LASAII Division of Uranga & Associates — This is a new model we have found and are particularly impressed with their grasp of the subject and client selectiveness. They position the Safe Harbor© process as investing outside the IRA with balanced application of assets from inside the IRA. This is sheer brilliance for the right investor.

DULY DILIGENT FOR BETTER RETURNS

There are three steps to selecting the right partner in this tax deferral:

1. Understand your options.
2. Select a custodian or financial advisor that understands self-directed, non-traditional investments.

Get their advice and verify this with a second opinion. Any of the custodians and administrators above will direct you to knowledgeable advisors. Uranga & Associates starts with client needs consulting. In all cases, a client will need thoughtful legal and accounting services that intimately understand self-direction. A great resource is “big gun” real estate tax lawyers and accountants, Kingman Winslow.

3. Establish your self-directed account. Invest wisely in long-term real estate (with leverage, income, and tax advantages). Expect a minimum of

secured 10 percent per year returns.

And if the investment world all “goes to custard,” and you bought real estate wisely for your account, you still have the equity and the income. Wall Street has delivered this “aha moment” for many investors. ■

RESOURCES

SDIRA Custodians & Administrators

Entrust Administration, Inc
www.iraplus.com
888-340-8977

Entrust Arizona
www.entrustarizona.com
866-459-4580

Equity Trust Company
www.trustetc.com
888-382-4727

Fiserv Investment Support Services
www.fiserviss.com
800-521-6974

PENSCO Trust
www.penscotrust.com
800-969-4472

Sterling Trust
www.sterlingtrustcompany.com
800-955-3434

Trust Administration Services
www.trustlynk.com
800-455-9472

Safe Harbor© — Offset taxes, not benefits.
LASAII, division of Uranga & Associates
www.urangafinancial.com
800-564-8625

Tax & Legal

Kingman Winslow, LLC
www.kingmanwinslow.com
602-954-2410

ProVision Wealth Strategies, CPA
www.provisionwealth.com
866-467-4444