SUPERCHARGE YOUR IRA THROUGH PRIVATE MONEY LENDING

Jim Ingersoll Real Estate Investor Bootcamp
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"Propriety information – Can Not Be Shared without consent from Mary Hart"

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IT'S ABOUT GRATITUDE…..

- I would not be here without a few very special people, to whom I owe much:
  - **Jim Ingersoll**
  - **Dyches Boddiford** (offers a great Hard Money Lending Class. Visit www.assets101.com)
  - **Dave Stech** (much of the following material is borrowed with permission from Dave)

Portions of these materials are used with the permission of Dave Stech and Dyches Boddiford.

IT'S NOT HOW MUCH YOU MAKE…. IT'S HOW MUCH YOU KEEP!

- Which would you rather have?
  - $1,000,000 cash RIGHT NOW…
  - OR
  - $0.01 (one penny) that doubles in value every day for 30 days?

The Answer…

- On day 30 - A penny that doubles every day for 30 days is worth:

- $5,368,709.12

DON'T BELIEVE ME??

DAY	VALUE
1	.01
2	.02
3	.04
4	.08
5	.16
6	.32
7	.64
8	1.28
9	2.56
10	5.12

KEEP WATCHING……

11	**10.24**
12	20.48
13	40.96
14	81.92
15	163.84
16	327.68
17	655.36
18	1310.72
19	2621.44
20	5242.88
21	10485.76
22	20971.52

VOILA!

23	**41943.04**
24	83886.08
25	167772.16
26	335544.32
27	671088.64
28	1342177.28
29	2684354.56
30	5368709.12

WHAT ABOUT TAXES?

- What would your answer be if you had to pay taxes on the growth of your penny?
- The answer may surprise you!
- Assume the growth is taxed at 28%....
- Your $5,368,709.12 drops to only

- $67,658.90

THE TAX DRAG!

- Uncle Sam's tax drag caused a 98.7% loss in your earnings on that penny!
- Now you see the powerful forces of:
  - Compound Interest (productive)
  - Compound Taxation (destructive)

THE BIG LESSON

IT IS NOT HOW MUCH YOU MAKE, IT IS HOW MUCH YOU KEEP!

ELIMINATE THE TAX DRAG… KEEP MORE

- Grow Your IRA!
  - Use your IRA to ***eliminate*** the tax drag on the growth of your investments!
    - **ROTH IRAs** - funded with after tax dollars and *NEVER* subject to income taxes on distribution (if you meet the rules).
    - Beneficiaries will not pay income taxes either.
    - **Traditional IRAs** – funded with pre-tax dollars and will pay income tax on distributions. *But, will GROW tax-deferred!*
    - Beneficiaries will pay income taxes

WHAT IS PRIVATE LENDING?

- The 6 F's of Real Estate Investing:
  - Find It
  - Figure It
  - FUND IT
  - Fix It
  - Fill It
  - Flip It

All but private lending require active participation = JOB!

FIND IT

- ***Determine*** your ideal product type
- ***Build and maintain*** relationships with birddogs and realtors
- ***Design and pay*** for direct mail marketing campaigns
- ***Pay*** for bandit sign campaigns
- ***Do a phone campaign*** yourself or pay to have it done
- ***Knock on doors*** or pay someone to do it
- ***Do daily MLS searches*** or pay someone to do it
- ***Sit at the auction*** or pay someone to do it

FIGURE IT

- ***Determine*** the cost of capital (unless you have money personally…but opportunity cost)
- ***Determine*** holding costs
- ***Determine*** construction needs and costs
- ***Perform*** a comparable sales analysis and rental analysis
- ***Order and pay for*** BPOs/appraisals
- ***Determine*** re-sale timing costs associated with commissions and closing costs
- ***Calculate*** expected cash-on-cash and annualized return

FIX IT

- ***Vet*** general contractors for track record, licensure and insurance
- ***Obtain*** a thorough scope of work with line-item pricing
- ***Compare*** against budget. Decide what stays and what goes
- ***Buy*** materials directly to avoid contractor up-charge
- ***Keep*** daily tabs on material inventory and the contractor to ensure milestones are met and completion date is met
- ***Inspect*** property for completeness. Blue tape areas of concern; oversee correction
- ***Write Checks*** along the way for materials, GCs and subs

FILL IT

- ***Fill it yourself***
  - ***Advertise***
  - ***Screen*** applicants
  - ***Run*** background checks
  - ***Draft*** lease agreements
  - ***Secure*** deposits
- ***Or vet and hire property manager***
  - ***Interview*** at least 3; check backgrounds and references
  - ***Hope they care as much as you do*** about your property
  - ***Shut up and pay!*** (Probably 8-10%)

FLIP IT

- ***Take*** final pictures
- ***Post*** to Craig's List, Backpage, Facebook, LinkedIn, etc.
- ***Answer*** calls from agents and buyers
- ***Negotiate*** best deal possible while being sensitive to DOM and CC
- ***Draft*** contracts, addendums, counteroffers, and disclosures
- ***Make*** any required repairs post-inspection
- ***Deal with*** appraiser and appraisal issues
- ***Pray*** it does not fall apart and you have to start all over
- ***Go to*** Closing and hope you get a check!

FLIPPING – WHO GETS PAID LAST?

- These people get paid before you do:
  - Contractor
  - Title company
  - Escrow/Closing Agent
  - Realtor
  - Lender
- MAYBE you get paid??

OR..You could just fund it!

- ***Vet the borrower*** for experience, integrity, financial situation (until repeat business established)
- ***Vet the deal*** for general value and marketability
- ***Secure your loan*** against the real property (I prefer 65% LTV or less)
- ***Make Money*** day 1 (points)
- ***Make Money*** every month (interest)
- ***Make Money*** when it closes (Profit Share)
- ***Rinse and Repeat!***

WHY PRIVATE LENDING?

- My favorite reasons:
  - Private lending generates higher returns with less risk than other asset classes
  - Immense size of opportunity
    - $13 trillion in outstanding mortgage balances
    - $2-3 trillion held as investment
  - Favorable Investor to Lender ratio
  - Awesome Effort-to-Return ratio
  - Win-loss ratio is unmatched if you know what you are doing
  - Services #1 need in real estate
  - She who has the Gold makes the Rules!

WHY PRIVATE LENDING - continued

- Not a JOB!
- Somewhat Passive investment – great for SDIRA investing (*so long as not lending to Disqualified Person)*
- Repeat and referral business
- Can leverage OPM, OPT and OPE
- Provides income that is
  - Sustainable
  - Leveraged
  - Recurring

RISK MITIGATION

- Whose money is safer?
  - If the deal loses money, who loses 1st?
  - With 65% LTV = built in 35% equity
  - 1st Lien position means lender is paid first
  - Often taking property back in defaulted loan makes more money than the interest

EFFORT TO RETURN RATIO (ERR)

- My favorite reason of all…..
  - Whose effort-to-return ratio (ERR) is better – the active or passive investor?

ACTIVE INVESTOR		PASSIVE INVESTOR	
Acquisition Price	(-$70,000)	Points (4%)	$2,600
Rehab	(-$10,000)	Interest (15%)	$3,250
Holding Cost	(-1,000)	Capital Cost (7%)	(-$1,517)
Gross Sales Price	$100,000		
Sales Costs	(-$7,000)	Capital Cost	(-$5,850)
Hours Invested	10		
NET PROFIT	$7,150	NET PROFIT	$4,333
Hours Invested	100	Hours Invested	10
Profit/Hour	$71.50	Profit/Hour	$433

#1 NEED OF REAL ESTATE INVESTORS

- What is, always has been, and always will be the #1 need for real estate investors?
  - MONEY!
- Is real estate investing going away?
  - NO!
- So, how can you service the #1 need in real estate AND make money without the tax drag?
  - PRIVATE LENDING THROUGH YOUR SDIRA

HOW PRIVATE LENDERS MAKE MONEY

- 1. Maximize ***Yield***
  - Yield is NOT interest
  - Yield is the annualized rate of return
    - (Sum of Revenue)/(Total Investment) x (Turns/year)
    - Ex: ($10,000 revenue)/$100,000 (loaned) x 4 times per year = 40% annualized return = YIELD
- 2. Maximize ***Spread***
  - Spread equals (Amount you charge borrower) minus (Amount you pay OPM)
  - Ex: $10,000 (received from borrower) minus $7,000 (paid to OPM) = $3,000 SPREAD

WAYS PRIVATE LENDERS CAN MAKE MONEY

- Due Diligence Fee
- Origination Points
- Interest Rate
- Cancellation Fee
- Extension Fee
- Velocity of Money
- Payoff Demand Fee
- Equity Share
- Preferred Min. return
- Escalators
- ROTH SDIRA
- Source cheap OPM
- Leverage

Perfect Wealth Accumulator

- Passive and recurring…not active
- Use your money or OPM and make the spread
- Extraordinary yields possible
- You control your risk
- You are in lowest risk position of anyone in deal
- You have a predetermined yield – can forecast income
- You get cash flow
- Easy to understand
- Replicable
- Scalable (if outside IRA)
- Need nothing more than computer, smart phone and printer
- Serves #1 need in real estate
- CAN BE DONE WHILE ON VACATION!

LENDING ESSENTIALS

- Understanding and controlling the transaction is critical!
- ***NEVER*** Do a deal if :
  - you do not understand it
  - the borrower cannot explain it
  - The borrower has insufficient income
  - The property cannot be valued properly
  - Without using a 3rd party escrow/closing agent
  - Without property insurance
  - On owner-occupied property
  - Loan will be unsecured

LENDING ESSENTIALS

- You must be comfortable with deal, collateral and borrower.
- You want a long-term relationship with an excellent borrower
- Collateral should be simple and homogenous to the area (easy to sell)
- If borrower cannot explain deal clearly – do not fund it!
- Must understand and verify the ***value***.
  - Value and price are not always the same

LENDING ESSENTIALS

- Rule #1 – It is your money (or your investor's $)
  - "Trust but Verify" everything the borrower tells you
  - 6 Due Diligence areas to review when considering a deal:
    - Borrower
    - Borrower's income
    - Location
    - Collateral
    - Market Conditions
    - Exit Strategy(ies)

LENDING ESSENTIALS

- Rule #2 - Borrowers will tell you what you want to hear!
  - Borrower's need to ***show you:***
    - Ability to repay
    - Experience in doing type of transaction they want you to fund
    - They have resources in place – financial, vendors, etc – to complete deal successfully

LENDING ESSENTIALS

- Rule #3 – Always protect your capital!
  - If borrower does not have ability to repay, your capital is at risk
  - You have flexibility in evaluating and accepting all sources and forms of income that borrower may have
  - Need to be able to evaluate alternate sources of income (non W-2 income)
  - If borrower is self-employed, you need to understand where he or she gets monthly cash flow

LENDING ESSENTIALS

- Rule #4 – Location, Location, Location!
  - Know exactly where property is located
  - Location influences selling price
  - 100 feet can mean the difference between a $100,000 vs. $1,000,000 selling price
  - School district is very important
  - Access to transportation, churches, etc can be important

LENDING ESSENTIALS

- Rule #5 – Borrower must know the collateral
  - If borrower cannot tell you the story about the collateral in 5 minutes or less, it is not a good deal
  - If borrower tells you it is a fixer upper, ask for budget and scope of work
    - Does there budget match scope of work?
      - Need to know something about rehab costs to assess accuracy
    - Are they doing improvements that market will not support?

LENDING ESSENTIALS

- Rule #6 – The market – not the property - drives the price
  - Markets are dynamic
  - Look at markets in 90 day windows
  - There are prime buying and selling markets and you must understand the demographics of these markets
    - Consider: employment base, school calendars, tourist seasons etc.
    - Markets are seasonal – if buyer buys in wrong part of cycle it can lengthen completion of deal by months
    - Check inventory of homes for sale in that time period
  - Know the end buyer's potential lenders – how long to get financing?

LENDING ESSENTIALS

- Rule #7 – What's more important? The Market or the deal?
  - IT DEPENDS!
  - In down market, the deal is more important
    - Don't have time to "wait it out" because mkt values are dropping
  - In up market, the market is more important
    - If deal goes long, market is your friend
    - Up market hides "deal sins" and "borrower sins"
    - Possible to have deal go awry in up market and more money than a perfect deal in a down market

LENDING ESSENTIALS

- Rule #8 – Know your own limitations!
  - Have multiple exit strategies to protect your capital
  - If borrower's only exit strategy is "fix and flip," you must verify that borrower has reserves and assets to pay you off at end of loan term
  - Value using both sales approach and income approach
  - Evaluate impact to your financial situation if you become an accidental "buy and hold" investor until market is right for resell

LENDING ESSENTIALS

- Rule #9 – Trust but Verify!
  - The word "NO" can be your best financial planning tool!
  - Pay attention to the details of the deal
  - If you move forward, make sure you have all the right paperwork to protect your "investment"

LENDING ESSENTIALS

- Rule #10 – Follow a consistent and logical process to fund deals with consistent profit
  - Trust your instincts and say “NO” if something does not feel right
  - Say “NO” if documentation is not accurate and adequate
  - Say “NO” if any information provided to you is more than 90 days old
  - Say “NO” if borrower tells you they have multiple lenders looking at the deal

LENDING BLUEPRINT

- 4 Components:
  - 1. Pre-funding
  - 2. Post-funding
  - 3. Payoff
  - 4. Post-Payoff

LENDING BLUEPRINT

- **Pre-Funding Process**

- “Gut-Check” review of
  - The Borrower
  - The Collateral
- Vetting the Borrower:
  - Real estate experience (check prior sales – review HUDs)
  - General business acumen
  - Prior work history and current employment
  - Prior use of private lender?
  - Why deal is great investment with high ROI for lender

LENDING BLUEPRINT

- **Pre-Funding Process**

- “Vetting the Borrower:
  - Important background information:
    - Verification of liquidity (proof of funds)
    - Borrower’s tax records
    - Borrower licensed?
  - Loan Application Process:
    - How quickly and thoroughly does borrower complete application?

LENDING BLUEPRINT

- **Pre-Funding Process**

- “Vetting the Borrower:
  - Verify Borrower’s Track Record
    - Utilize property records to review up to 5 of borrower’s past transactions
    - Verify the following:
      - Was entity on title what they claimed it was?
      - Was property purchased when and for the amount claimed?
      - Was property re-sold when and for amount claimed?

LENDING BLUEPRINT

- **Pre-Funding Process**

- Vetting the Collateral:
  - Type of Sale (REO, Short sale Non-distressed)
  - Location of property
  - Acquisition costs and rehab requirements
  - Amount of time borrower needs capital
  - Expectation of terms (interest rate, origination fee, timeframe etc)

LENDING BLUEPRINT

- **Pre-Funding Process**

- For loans involving renovation:
  - Analyze scope of work and timelines; compare to pictures/videos
  - Call contractor to discuss general project and major issues
  - Documents required of contractor:
    - Contractor license; insurance; 2 months of bank statements; most recent year's tax return

LENDING BLUEPRINT

- **Pre-Funding Process**

- Confirm Value of Property
  - MLS search 1st
  - BPO (if MLS not available)
  - Appraisal if needed (costs of BPO/appraisal paid by borrower via due diligence fee)

LENDING BLUEPRINT

- **Pre-Funding Process**

- Preliminary Title Review:
  - Use title company you know
  - Do not accept directly from borrower
  - Identify and verify title holders, lien holders, and potential claim holders to property
  - Key elements to identify from title search:
    - Current owner of record
    - Open Mortgages
    - Open Liens
    - Easements, rights-of-way, boundary issues
  - Ensure with title company that all encumbrances will be cleared and/or insured against

LENDING BLUEPRINT

- **Pre-Funding Process**

- Final negotiations with Borrower – execute Term Sheet
  - Term sheet = written, binding agreement between lender and buyer
  - Should contain at least
    - Lending party
    - Borrower
    - Address of collateral
    - Collateral type
    - Amt and term of capital
    - Capital contribution from borrower
    - Scope of work (if applicable)
    - Repayment terms
    - Pre-payment penalty provisions
    - Insurance requirements
    - Exclusivity provisions

LENDING BLUEPRINT

- **Pre-Funding Process**
- Verify property insurance with provider
  - Extended coverage hazard and liability insurance for full replacement cost or loan amount
  - Flood certification (is flood insurance required?)
- FOR SDIRA – must complete appropriate forms as required by custodian
  - Custodian will sign all paperwork for loan and will wire funds
  - Loan must be in the name of IRA: ex: “Quest IRA CFBO Mary Hart IRA #123456”

LENDING BLUEPRINT

- **Pre-Funding Process**

- Wire Funds (Custodian wires for SDIRA)
  - Obtain wiring instructions directly from escrow
  - Confirm closing instructions with escrow
  - Set up wire from investment account
  - Approve wire (dual controls)
  - Confirm receipt of funds with escrow
  - Verify all underlying payoffs

LENDING BLUEPRINT

- **Funding Process**
- Confirm all docs are signed and borrower's funds (if applicable) are with escrow agent
- Confirm all payoffs will be made

LENDING BLUEPRINT

- **Post-Funding Process**

- Verify receipt of all closing docs
  - Promissory Note
  - Deed of Trust/Assignment of Rents
  - Investor Certification
  - Affidavit of Residency
  - Title Insurance Policy
  - Hazard Insurance Policy
- Review for completeness and accuracy

LENDING BLUEPRINT

- **Post-Funding Process**

- For Rehab Loans:
  - Make sure all parties know how funds will be dispersed
  - Typically best to pay contractors directly (but probably will not work with SDIRA)
  - Draw Requests
    - Contractor submits written summary of work
    - Prepare a lien waiver for property
    - Contractor signs (and has notarized) lien waiver
  - Contact borrower periodically for updates

LENDING BLUEPRINT

- **Payoff Process**

- When asked for payoff:
  - Confirm date of closing
  - Review payoff statement (or prepare)
  - Send original promissory note marked "Paid in Full" to closing agent
  - Confirm wire amount matches payoff statement (including per diem if closes late)
  - Execute a release of lien

LENDING BLUEPRINT

- **Post-Payoff Process**

- Best part! You are getting a bigger check!
- Verify all is completed
- Ask borrower if they have additional funding needs
- Ask borrower for testimonial and referrals