How To Use "Small-Dollar" Self-Directed IRAs To Invest In Real Estate

Hosted by: Joe McCall
Guest: Jeff Watson

Joe: All right, welcome, everybody. This is the Real Estate Investing Mastery podcast. Glad you're here. And on this episode, we're going to be talking about a really unique way. I'm introducing you, first of all, to my good friend, Jeff Watson, who's an attorney has been doing real estate investing for a long, long time and knows the good, the bad and the ugly of this business. And we're going to be talking about a real simple and effective way as we're in tax season now of how to take a few thousand dollars and invest it in tax sheltered things. We're going to talk about the details, what those things are. And there's a real need right now with a lot of landlords out there that need money. They need money because they're tenants aren't paying them rent. They need money to help the mortgage payments or whatnot.

Joe: And he's got a very unique strategy to lend money into this tax-sheltered account and get a really good rate of return on it and take that. Well, I don't want to talk numbers here. I'll let Jeff do that. But it's something that I am doing right now. I saw one of his emails. I watched one of his webinars. I said, oh, my gosh, that's amazing. I went and I opened up one of these accounts. I put some money in it. And I want to learn with Jeff, with you guys coming along with us on how to do this. It's a real simple, powerful, effective strategy and think you're going to like the details here. So, Jeff, Jeff Watson from Ohio, how are you, man?

Jeff: I'm doing better and better, brother. It's good to see.

Joe: You're wearing the Ohio State shirt on, right? That's OK.

Jeff: When you have a public university in your state that has the best marching band in the business and one of the best college football programs ever. You're kind of proud of it. So you just kind of you just kind of push it on other people's noses, you know.

Joe: I'll save the jokes. I was going to say something stupid. Listen, guys. Jeff, you've been in the business a long, long time. You're an attorney, and we won't hold that against you. But you've been doing business a long time and you understand wholesaling, lease options, subject to, owner financing, fix and flip, buy and hold. You've done it all. Talk a little bit about, the thing I love about working with you is you understand the creative side of real estate investing. You understand the right way to do it and the wrong way to do it, the things to avoid. We talk just briefly about how you get started in the business and what you're doing today.

Jeff: I got started in the business because I recognized that real estate was the best way to build true wealth. And then I got confused. I got distracted. I forgot what the objective was because I got so deep into the into the swamp with the big alligators, I forgot the draining the swamp was the true objective.

Jeff: And now I found my way back out of it. And I have gotten on the cusp of what we all are chasing, called financial freedom. And I'm to the point now where I'm blessed. I don't have to work again. I want to not only do the stuff I want to do and it's a lot of fun. There's some stuff I passionately care about and I'm involved in and there's some stuff that I'm just I'm not doing it anymore. Been there, done that, bought the t shirt, paid the bills, stitched up the cuts, they're scars. They tell great stories and I'm done. Moving on.

Joe: So what interested you in law? Why did you go that route?

Jeff: That's funny. There's two parts that's funny. Number one, I thought I was going to be I thought I was going to be First Amendment free exercise. Well, that's what I thought I was going to do when I was in high school and college. And then I got into law school and I took this class called Constitutional Law, and I thought it was really constipated law and I just didn't enjoy it.

Jeff: Evidence made sense. Rules of civil procedure made sense. Courtroom litigation was fun. So I spent 30 years, pretty much thirty years doing plaintiff trial work, representing a lot of injured workers in that in that time frame, I took 20 different jury trials, which is a high number for civil litigation attorney. Changed the law in the state of Ohio five times through litigation or legislation, took a couple. It took one case all the way to the Supreme Court, took one case all the way through the Ohio court of claims, a couple other appellate cases, and then one case co-counsel that the appellate level, but also led the charge in the legislative body to amend the Ohio revised code on benefit of landlords.

Jeff: But law was a passion that God gave me to just do one thing, help people. And realized I can help people by doing other things besides just law. And one of my now passions is talking to people who are like me that have worked really hard. They've got a portfolio of properties. Hopefully they're getting them free and clear so they can keep them. And then they look around, they go, oh, my soul, my retirement account balances aren't near what they should be. What do I do about that? And I've been working on that for a while. And I'll just tell you right now, I had a really rude awakening. This guy is still a friend of mine today, went into his office when he was running a lending company and I had fifty thousand dollars into an IRA. And I said, I want to start doing lending with you.

Jeff: And he looked at the account balance, looked at the numbers and said, Jeff you don't have enough money to make it worth my while, I was crushed. Really, I was just crushed. And Tom's still a good friend. I mean. Exchange with him quite often, I was crushed and I walked out of there and I vowed that I was going to find a way for small dollar accounts, small dollar accounts to make money. And I fiddled around with this and tried this, and I turned three thousand dollars into three thousand dollars in three years and I've turned six thousand dollars into sixty thousand dollars in five years. But now I have dialed it in and I have found a rinse and repeat, a very simple solution process methodology that you can literally take a small account balance, start with a thousand dollars and do certain key tactics. And about seven years you're at a six-figure account.

Joe: Oh, I love this. So let's just jump right into it. You know, this is something that I saw an email you sent to your list about. I thought that looks really good. I got excited about it. I watched you.

Jeff: You texted me. You called me just as I was getting ready to go do something else about it. I was like, dude, hold on, let me get this done and I'll be here.

Joe: I appreciate you taking my call, too.

Jeff: Oh, well, I got back to you the same day. I think you did.

Joe: Well, yeah, I texted you and I called you left a voicemail. I don't remember what it was. I was probably being that annoying pest, but I got so excited about this because I want to do it. And I think a lot of my podcast listeners, people on my email list, YouTube subscribers, I think they will be interested in this, too. This is a great way to take a little bit of money. You don't have to have hundreds of thousands of dollars, but you can get a little bit of money and talk about what this is, Jeff, like, how does it work?

Jeff: OK, so I'm going to I'm going to lay it all out with a couple of features and benefits and so on, and then we'll get into the details. This is the sad part of what I do. A lot of my clients now are self-directed IRA account holders and probably once a month now I'm contacted by somebody asking for help about a deal that they did. They went wrong. And it's a six-figure mistake. And I think about how many years somebody spent working, making the minimum contributions, making the contributions to get the one hundred thousand dollars in their IRA only to have some thieves steal. It breaks my heart. So one of the things that I focused on is I got to find a way to do small dollar deals because if I lose small money, I only lose small money. I'd rather get thrown out trying to steal second than getting thrown out, trying to steal home, use a baseball analogy for whatever reason.

Jeff: But then I also say there's got to be a way to grow this money. There's got to be a way to grow this money. And then a guy that really taught me a lot, you never really knew it is the late Henry Devorkan out of Wichita Falls, Texas. People in my industry would refer to him as Mr. Henry, OK? And Mr. Henry started learning real estate investing and so on when his dad was practicing law in the Depression in Texas. And I learned the power of compounding of a principal from him that we simply that I've simply paraphrased called the Ten for Twelve. So, Joe, it really comes down to this. I'll make you a ten-thousand-dollar loan in exchange for twelve payments of a thousand dollars. And then you take that situation and you apply it to today with thousands of landlords that need money, like they need oxygen through no fault of their own, because their tenants, often through no fault of their own, don't have jobs that aren't making enough money. They can't pay the rent.

Jeff: And if we can give a bridge loan to those landlords to help them hold on until the tenant gets another surplus relief subsidy fund, which is coming this coming or the tenant gets back to work or this or that, then we can save that landlord's property and we can keep that good tenant in that good property and keep the relationship preserved because evicting a bunch of tenants going into 2021 is a bad idea. Who are you going to put in your new vacant unit, other tenants that somebody else evicted? That's not smart. Yeah, let's find a way to keep them. That's what that's what I saw this all come together. I know this this is obvious. This makes sense. People up. I mean, it's quick. It's simple. By the way, how many landlords can go to a bank and borrow ten grand? Oh, we need to get an appraisal. Oh, we need to send it to underwriting. Oh, we got to check your FICO score. Oh, we know. Let's make sure it's a deserving land with a good property and a good tenant. Look at a couple of things on their schedule E and rock on man.

Joe: OK, so what this is, is you put some money into what, a self-directed IRA?

Jeff: Yes, that is self-directed. Roth IRA. I live for and love self-directed Roth IRAs because I can put money in, I can grow it tax free, I can then take it out tax free and I don't have to pay any taxes on it. It's like I'm running downhill with a tailwind as far as depreciation and accumulation of taxes and then I'm on smooth sailing when I get to take it out. Because they don't have to pay taxes on anybody or anybody with earned income, even somebody who makes as much money as you or I do. We can still qualify for a Roth IRA through a back-door conversion. I don't care who you are. If you can afford the mayor and you've got earned income, you can form a Roth IRA now and you have a company that you recommend.

Joe: Do you want to?

Jeff: Because I'm on the board of directors of Quest Trusts so I love them and they are hands down. In my opinion, when you want to do private lending, they are the custodian of choice, of private lending out of a self-directed retirement account is embedded in their DNA code.

Joe: Good. What is their website? I want to just send people to it right now if they're interested.

Jeff: QuestTrust.com. They're headquartered in Houston, Texas, offices in Dallas, Austin and San Antonio. The guy that founded the company is the smartest hire a lawyer in America. Quincy Long is a good friend of mine. It's a growing, vibrant company. The culture there is fantastic. And I will tell you just this week, and this is really in the week, but just this week, I've had two encounters with other custodial companies on behalf of clients where the phone wait time is an hour or longer to talk of human being. That is unacceptable at Quest Trust.

Joe: Quest is amazing. And I've already contacted them. I'm in the process, the guy you sent me? His name Kevin or Derek? I thought it was Kevin.

Jeff: Rebecca said Kevin. Yeah, ok. Got it. Yeah.

Joe: All right. So we're in the process of doing that right now. Let's talk about this now. Who is the landlord that we can lend this money to? I like that. And it's real simple. Ten grand for twelve payments of a thousand. That's more than a twenty percent return on your money, isn't it?

Jeff: On the outward face, the landlord is paying about a twenty percent rate of return at twenty percent interest on the money. OK, that's cheaper than Visa, MasterCard, Discover or American Express will put it out. It's faster than a bank'll put it out. And it is with a human being who understands your business doing it, OK? And I show people what to look for, how to look for it. The questions to ask to determine who's the deserving landlord with a good tenant and a good property versus that landlord that really shouldn't be a landlord. And we really don't want to do business with them. So I teach that and I show people how to make that call. And then it's the landlord right now that we're looking at that. Twenty nineteen was a good year. 2020 is a dumpster fire for them. And because they've had high vacancies or high non pays, they're struggling and they might have taxes, they might have some insurance issues, they might need some maintenance and they can't find the money.

Jeff: I mean, literally, I just did one of these deals because I didn't want to reach into my retained earnings account and go dress up one of my rentals. So I just reached out to a friend of mine and I said, hey, Carol, you got a couple of thousand bucks sitting around and she had twelve. And so I'm taking twelve and making payments on it and away we go. But I got three contracts and crew is rocking and rolling and we've got a new roof on a house, a garage disposed, two new porches done and the whole bit. All with that, bang.

Joe: OK, so we're looking for a landlord who needs some cash. There's obviously there has to be some equity in the house because you're securing this without help, right?

Jeff: I'm not really I'm not really focused on the equity, but I don't want to be in worse than second position. What I'm really looking at is the cash flow. So I teach people how to do this by going and getting that landlord eventually for the previous year. The scheduling is how the landlord reports their income, expenses and so on for that rental property. I teach them how to analyze the scheduling and how to recompute on the schedule to really see what is the true net effective cash flow or net effective operating income. Because a lot of landlords, particularly if they listen to guys like me, we can run a property where on paper it's losing money, but in reality it's still putting money in their pocket.

Jeff: OK, I'm going. Well, there's this magic thing called depreciation. OK, so once we factor back in, once we take that and add that back up in to the A.I, then we're like, oh, OK. Because depreciation, the landlord doesn't sit down to write a check for depreciation. It's a gift given to them by Congress. So they take advantage of it. OK, there's a couple other things to look at to say, OK, really is this ah, this is what we're doing or not doing to really determine the net effect of operating income.

Joe: OK, so then what kind of properties are you looking for? What kind of properties do these landlords have?

Jeff: I think the typical landlord is anywhere from a single-family residence to probably an eight to. The bigger guys, they're probably not going to want to they're not they're not going to be people you're going to normally see at the typical meet ups, Ria's, et cetera, and so on. They're not they're not in all the chat groups that you can reach out to and say, hey, I make short term bridge loans to deserving landlords with good tenants and good properties. And by the way, there was your marketing spiel right there?

Joe: I love that. If you notice that I don't have a pen and paper, I would have written it down. That's really good. These are short term bridge loans, guys. I've used them before. I've used them before. Nothing wrong with that. There's times when you just are short on liquid capital. You don't have the money to do what you do, and especially if you've got some vacancies. But you as an investor now through a self-directed IRA, which you profits and your gains are tax free stuff. Right? Right. You can find these landlords. And right now they're really easy to find these guys that need just a short term bridge loan. You can lend them the money. And correct me if I'm wrong, right or wrong, the money is secured with the property. Talk about how it's how is it secured, kept safe.

Jeff: So we use there are four key documents in this transaction. There's the promissory note, commercial promissory note that lays out the terms I'm lending you ten thousand dollars.

You're going to make me twelve payments beginning 30 days from now of a thousand dollars a month. You're going to send the check payable to Quest Trust Company Custodian FBO Joe Call Account Number one two four five nine four, whatever number it is they give you and they're going to send it to you to make sure that you get the check and you mark it off on your check sheet, that you got it and then you can forward it on to Quest. That's the first document. The second document is either a mortgage or a deed of trust, depending on what state you're in. We secure this with either a mortgage or indeed a trust. These are secured notes. Collateral backs them up in.

Jeff: The next document that we use is an assignment of rents. I do as an assignment to rents outside of my mortgage or deed of trust that says, hey, the landlord agrees to assign rents to me to make these payments, but I'm not going to enforce the assignment until the landlord doesn't make a payment on time. And then I have something in writing signed by the landlord that says, Hey, tenant, you got to pay this lender, Quest Trust Company, Custodian, FBO will call account number, whatever at this address. And that's where you got to send your rent, too. And so then if you have to, you go and force that by notifying the tenants, hey, according to something signed by your landlord, you've got to start sending the rent checks to me and what I've now started to do and then this.

Jeff: I've not had this. I've not tested this long. So I'm going to put this out there. This is really in beta is that when I do a deal with the landlord, I will now notify the tenant saying, hey, because of the good landlord tenant relationship, X, Y, Z company is coming alongside with and working with your landlord for the next thirteen, fourteen months to make a provide a better-quality property for you.

Jeff: You don't need to do anything. If something changes we'll be letting you know. But everything is good between you and your landlord. Just want you to know that because you're such a good tenant, your landlord qualified for this program. Nice. How do you think the tenant's going to feel? How do you think the landlord is going to feel now? If four months from now, my landlord turns out to be a scuzz bucket. The tenant is not hearing from a total stranger. It's just a thought in the last year for the last document is the particular direction of investment form required by your custodian quest trust for any of the other companies that would you would use. And you will instruct Quest in how to send the check, where to send it, to whom to make it payable to and so on. And you're going to make it payable to the landlord.

Jeff: But you're going to send it to the account holders' attention and you're going to give them the check when you meet them at the title company that is going to record your mortgage as an accommodation. You don't have the title company to do escrow, you hire the title company to do two things. Do a current order and lien search and for the accommodation of recording the mortgage due to trust. And by the way, landlord borrower pays those two costs directly, taken out of the loan proceeds and then you're done.

Joe: So this isn't a desktop closing type of thing. This is where you're actually using a title company to make sure all the paperwork is done properly.

Jeff: Making sure that it's recorded properly. You the account holder, is a self-directed account holder. You've got to make sure your paperwork's good, OK? And then you want to make sure it gets recorded because I don't trust anybody to get my stuff recorded except either me or title company that I'm paying to go do it. Never I'm to say this again. Never. I'm going to say this one more time. Never trust the borrower to record the mortgage or deed of trust. It won't happen.

Joe: I can hear somebody say, all right, well, I find a landlord who has a tenant that hasn't paid in six months.

Jeff: Why haven't they paid? That's the first question I want to know.

Joe: They're a waitress and they lost their job. Right. And so but this guy has a lot of equity in this house. The landlord has a lot of equity in the house. Would you still lend him a bridge loan, even though there is no real assignments of rents that you can?

Jeff: There's not any rents coming in yet, but there will be. I'd still do the deal because what I'd want to know is, OK, let's look at your 2019 schedule E scheduled rents, the schedule rents. How much did you collect on this property? What were your expenses that year? How much money did you make or lose? And so on.

Jeff: So were you making money with this property in 2019 before the coronavirus shut everything down? If the answer is yes, then I want to make the loan. If the answer is no, I'm going to find out why. Is it because you got huge depreciation? OK, that's not a problem is it. Because you're underreporting your taxes to the IRS? I'm not doing business with you, ma'am. Is it because you had a huge onetime expense? OK, fine. Let's look and see what you did in '18 and just kind of dig in there and see what we got.

Joe: All right. So the whole point is take a little bit of money, lend it to a landlord who's got some property. It's a bridge loan to short term bridge loan. You get that money back 20 percent plus or minus more than the profits stay in the IRA. And as the account grows, you keep on lending more and more out. It's as simple as that.

Jeff: It's as simple as that. There's one other component to it. You commit to making a monthly contribution to your own future retirement so that the future Joe says thank you to the 2020 Joe for starting to put five hundred dollars a month into that Roth IRA. As I show an example, if you start with a thousand dollars, an eight-thousand-dollar loan, collect 12 payments of eight hundred dollars a month and make your five hundred dollars a month contribution at the end of year one, you've got enough money to go through two loans and you keep doing that process.

Jeff: And at the end of seven years, you now have enough money to be doing a loan every three weeks, every three weeks. And so just think about this. If you've got about one hundred and forty thousand dollars in your earning it right around 20 percent on one hundred and forty thousand dollars, that's suspiciously like twenty-eight thousand dollars a year. Right. I think that's half of what the family of a typical family makes a year in the United States. And you're making it all tax free.

Joe: Yeah. And it comes out that this is a great, great starting point. Cool. All right. So there's a lot more details. And I've asked Jeff, can we do a webinar to my list? And later, as we're recording this later this week, I believe Thursday we're going to be doing this webinar. It'll be live. You can get on and ask questions. And if you missed it, you can watch the replay. We don't know how long the replay will be up, but if you're going to JoeMcCall.com/jeff. JoeMcCall.com/Jeff, you'll see the details of either the live webinar or the replay of this. And we'll also have some links in there and some information about Quest Trust and that information. And you can get some information on Jeff and how to reach him. But this webinar is going to be really good talk just real briefly about what you're going to be covering in this webinar.

Jeff: I'm going to walk you through with pictures and examples of what we've been talking about for the last twenty-five minutes so that you can because some people are right, some people are left brain. And I want people to see it from both sides. It's like a snowball that once you can accumulate a certain amount of what I call critical mass, it becomes a just self-feeding, growing machine that just will do one thing for you. Spit out tax free cash. I don't know about you, but I love tax free cash. I just enjoy that immensely.

Joe: I love that analogy that you used to open up an account with seven or eight thousand dollars. You lend it out, you get about 20 percent back, but you're also contributing five hundred dollars a month into that. You can keep on repeating that. And in how many years? Seven years.

Jeff: Seven years. Seven years. At that pace, you're over one hundred thousand dollars. You're rocking. And I mean about the eighth year, you're like one hundred thirty hundred, one hundred forty thousand dollars. I've got it all explained out in the slide deck that they'll see in the webinar that we're doing live on Thursday.

Joe: And then you take twenty-three thousand dollars a year and interest income tax free.

Jeff: Tax free. Yeah, yeah. It's a real shame. It really is. It's very difficult. It's I mean, it's it's scandalous, you know. I mean, this is one of the things I struggled with for so long is that we've got this tendency, particularly since I'm a lawyer, to make things complicated and I strive to find how to kiss it, keep it super simple. And I found this is a program that keeps it really super simple.

Joe: Excellent. All right, we're going to talk about it, how to make sure you're picking the right landlords, you're protecting yourself, and you're not lending to an idiot. You've got, you have to set it up right. So your money's protected. You can get it back if you need to. The worst, worst, worst case. You have to foreclose on the home, right?

Jeff: Yeah, that's the worst case is you have to foreclose on the home, but you just got equity in it. That's a real shame. You know, it breaks my heart. Mean, maybe in that situation I got an idea. If there's enough equity in that deal, I might just buy your note from you. I know it's a default to I just might buy it from you. Finish the foreclosure myself, OK? Yeah, you're right. And you could see right through that they're going to know. Yeah, I want to just try to steal some money maybe.

Joe: All right. So this is such a cool topic. And some of you guys, you may be confused. I might have gone over your head. We tried real hard to keep it simple, but it is actually really, really simple. It's there's a there's a thing called self-directed IRAs, and you can invest money and lend the money out, get really good interest on it. It's secured by real estate. So it's very, very safe. And of all the guys I know in this industry, Jeff is the guy to go to learn the right safe way to do it. You don't want to screw it up and not let you screw it up if you don't get mad at you and coming down on you.

Jeff: Well, you don't want to see me mad or you don't want to see me sad, OK? And I mean, my heart breaks for some of the folks I've worked with in the last year that just made loans that they just didn't understand what they were doing and it hurts. So if you follow the step by step formula that I lay out, if you folks to attend the webinar take notes, you get a chance to move on from there. But just dig into it because it's, I keep it simple. Too many people have this tendency to overcomplicate things. And I don't want anybody to do something that they don't understand. I want you to understand it. It's really simple. I'm going to give you ten thousand dollars. You're going to give me back twelve payments of a thousand dollars. Once you get that down, then it's always that to me personally, it's my self-directed retirement account.

Jeff: Going to give you ten thousand dollars. Oh, you're going to give me back twelve payments of a thousand dollars payable to my self-directed retirement account so that two thousand dollars of interest that two thousand dollars of profit goes into my self-directed IRA, which is exempt from paying taxes and doesn't trigger any of the other stuff the people get all confused about and so on. And so then I've got that two thousand dollars plus the original amount of money in there to go back out and lend, plus the money I've been contributing since then and I just saw the first year I do one loan. You're number two. I do two loans. Your number three, I do three loans. Yeah, that's not a lot of work.

Joe: Yeah. It really grows and it's pretty easy to show how your ROI on this is better than putting that money into your own rental property. You know, so sometimes if something there's a place for being a landlord, but sometimes there's a place for being the bank. Right.

Jeff: Yeah. So and that's what you bring up a really good point. And this goes back to a strategy that I developed years ago, which was I watched a lot of farmers sit on a three-legged stool and milk t by hand some cows. And so I've got a three legged stool for my future. And one of them is self-directed retirement accounts. One of them is free and clear rental properties, and one of them is stuff in the stock market. And then I just sprinkle on top of stuff I still do working. And those three pillars give me a really good foundation. I love owning real estate, but I really love lending money.

Joe: All right, very good. I wanted this to be short and sweet to the point. Guys, go watch this webinar that me and Jeff are going to do in a couple of three days now. But even if you're listening to this later, you can watch the replay at joemccall.com/Jeff. And it's going to be real good. If you've any interest in this. This is the best place to go to learn how to do it. All right. And we're coming into tax season.

Jeff: And so now we're coming into tax season. And so there's some real some significance to doing this. And oh, by the way, just to tease a couple of people you can do this with besides self-directed Roth IRAs, you can do this with traditional IRAs. You can do this with 401Ks. You can do this with H. S A's. Now, if that isn't sexy, I don't know what is a health savings account making a loan like that and getting that kind of rate of return. Oh, yeah, baby, I get interested in that. You just do those things and the money that shows up in an HSA, I can use it the day after it hits the account tax free for health-related expenses. What better world is that? I can't think of one, you know.

Joe: Yeah. All right. This is good. Good stuff. Thank you, Jeff, so much for your time. Thank you for being here again. That. That trust equity, the IRA company, it's called Quest Trust. QuestTrust.com. Make sure you check them out and then watch our web, JoeMcCall.com/jeff.. Anything else? Final thoughts, Jeff?

Jeff: You know, I will throw this last thing out. It's completely unsolicited. Is that time of the year or folks, we need to spend some time really praying for country. We've got to pray for some solutions. Pray for how you can be a solution in your own backyard to some of the massive issues facing our great country.

Joe: Well, that's a good point. All right. Thank you, Jeff. We will talk to you soon. Talk to you later. Thank you again, everybody. We'll see you guys.