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CHECKBOOK LLC: A NEW METHOD IN REAL ESTATE INVESTING

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In today's profitable real estate environment, many investors find themselves interested in acquiring real properties that are both income producing and which appreciate at a better rate than the returns on stocks and bonds. Conservatively invested retirement accounts may yield less than 1% in money market accounts, bonds may provide weak returns and many investors fear investment in stocks due to the risk of another stock market downturn or correction like the March 5, 2009 correction where the market dropped more than 50% (from a high of 14,168.43 on October 9, 2007 to 6,594.44 on March 5, 2009). These concerns have many people looking to invest in real estate as an alternative to their current investment posture.

Many investors would like to invest in real estate or acquire certain precious metals such as gold or silver but incorrectly assume they cannot do so because their monies are tied up in IRAs, 401Ks, etc. There is a growing trend of cash purchases of real estate, many of which involve retirement funds. Southwest Florida is leading the nation in this trend. According to a recent study published by Realty Trac®, the Southwest Florida marketplace has had the largest percentage of cash buyers in the United States. Through the first quarter of 2014, this Realty Trac® study has shown that 73.6% of all residential sales in Lee County were cash transactions, leading the nation in percentage of cash purchases. A growing percentage of these sales have been fueled by an approved investment approach to legally utilize retirement funds for real estate investments: Checkbook LLCs.

Essentially, a Checkbook LLC is a Self-Directed Individual Retirement format. It uses a designated IRA that allows the account owner and the LLC (whose manager is the Investor) to direct the account Trustee to access a far broader range of investment opportunities, including real estate. The Checkbook LLC enables the beneficiary to allocate protected investment funds into the purchase of real estate or precious metals for what potentially could result in a safer and ideally higher yield in their portfolios. This format allows investors not only to buy real estate but to utilize retirement funds for venture capital

The Checkbook, LLC allows for diversification of a portfolio and takes advantage of the booming real estate market in Southwest Florida. However, to maintain diversity and to minimize risk, many advisors recommend that no more than 15%-20% of assets be acquired in alternative investments such as real estate with the rest in the mix of stocks and bonds. Initially, of course, one way to minimize risk and unexpected surprises is to fundamentally understand the investment and, in this particular case, the underlying real estate investment.

The following steps are to be followed by an investor to position himself/herself to utilize retirement funds and establish a Checkbook LLC to acquire real estate:

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1. Identify and establish a Self-Directed IRA Account with an accredited IRA Custodian who is IRS Approved, FDIC backed and is considered the “Passive Custodian”.
2. Have the IRS approved Passive Custodian transfer retirement funds into the new Self-Directed IRA.
3. Establish a limited liability company by using a qualified Attorney and identify that the LLC has the IRA Account Owner designated as the Manager and the actual Self-Directed IRA as the Owner of the LLC.
4. At the direction of the LLC Manager, the approved Passive Custodian transfers and invests the IRA funds into the newly formed LLC, referred to as the “Checkbook LLC”.
5. The Manager of the newly established IRA LLC (Checkbook LLC) directs all or a portion of the IRA funds held in the new LLC bank account for investment into the real estate to be acquired in the same manner as if the funds were readily available and the LLC would be investing its own funds to acquire the real estate.
6. The LLC, through a business decision by its Manager (the IRA Account Owner), makes the investment using the IRA funds. If properly set up and administered following IRS guidelines, all income and gains generally flow back to the LLC tax free.

Again, there are a number of moving parts to this format but the key point is to initially make sure that an appropriate IRS approved Passive Custodian handles the establishment of the IRA Account. Then have a qualified Attorney prepare the LLC in accordance with the directions of the IRA Passive Custodian. There are substantial taxes and penalties if you do not following the Internal Revenue Guidelines. These alternative investments utilizing your IRA/401K may prove to be beneficial in not only diversifying but ideally increasing the return on your investment portfolio.

Fundamentally all of the remaining essential issues of any real estate investment (analysis of the investment transaction, due diligence investigation, title review and closing) need to be addressed just as in any other real estate transaction.

Another positive feature in using Checkbook LLCs is that it eliminates the necessity to submit contract offers that are contingent on financing since the purchase will be in cash. This may give the Investor an edge against other offers that contain a financing contingency and may allow the closing to take place sooner, again elevating the status of the cash offer vs the offer with a financing contingency. Of course, the cash offer also eliminates not only the delay (and uncertainty) in obtaining financing but eliminates the loan fees, mortgagee title insurance fees, documentary stamp tax, intangible tax and recording costs incurred when utilizing acquisition financing. Lastly of course, the Checkbook LLC method eliminates the interest cost of carrying the underlying financing, further enhancing the overall return on the real estate investment.

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Our law firm has the ability to prepare Checkbook LLCs for real estate transactions in conjunction with the use of an approved IRA Passive Custodian. As an AV rated, Florida Bar Board Certified Real Estate attorney and based upon over thirty (30) years of experience in successfully handling thousands of real estate transactions in Southwest Florida, we can professionally assist and close the entire transaction. Our services include:

- Creating the underlying LLC
- Working with an accredited and qualified IRA Passive Custodian
- Assisting the buyer in identifying appropriate investment properties
- Working in conjunction with qualified real estate brokers and agents
- Drafting the contract for purchase
- Assisting in due diligence
- Reviewing and issuing title insurance
- Preparing the closing documents and closing the real estate transaction with the overarching goal: ***“Close the Deal. Protect the ClientSM”***.

Like any other investment, the underlying risk of a real estate transaction needs to be carefully evaluated by the Investor and his tax consultants. Investing retirement funds into real estate rather than keeping them safe harbored in a low yielding money market or cash position may prove to be a sound investment strategy. However, there is also countervailing risk that the prospective investment in real estate could result in possible risk of loss by another market downturn in the real estate economy. In Southwest Florida, based upon the significant amount of cash purchases, the risk of another mortgage foreclosure crisis has been reduced based upon the high percentage of owners of real property purchasing for cash rather than financing. Many real estate agents and brokers are encouraging their investor clients to consider Checkbook LLCs as an alternative method to acquire real estate.

For more information on our firm, profiles of our attorneys and services we offer, please visit us at www.KFJLaw.com or call to speak with one of our qualified attorneys at (239) 337-1147.

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