Retirement Investing 101

Breaking Free from the Status Quo

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There is a widely held perception that money saved for retirement MUST reside in one or more of three asset classes: an interest-bearing money market account, bonds, and stocks (whether individual equities or funds). This must be done, or so the theory goes, to preserve the significant tax advantages that are imbued in retirements, such as the Solo 401(k), the Roth IRA and the traditional IRA.

This, of course, could not be further from the truth.

The fact of the matter is the Federal Government left the door open for creative entrepreneurs to step forward with transformative entities and empower Americans to invest in an assortment of classes. In 2018, those entities are taking hold, promising a healthier retirement investment strategy that embraces diversification.

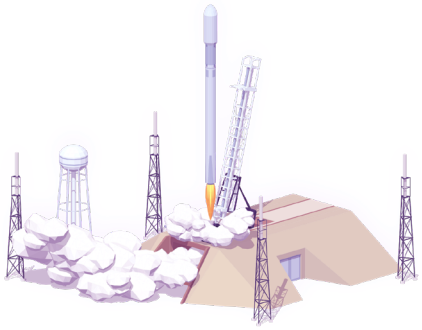
What do these entities look like?

They act as an agent for custodial banks, providing record keeping and tax reporting for non-traditional assets. For qualified plans, such as the Solo 401(k), they provide the plan document, which is qualified under the IRS code. They also provide record-keeping services for the selected plan assets. Finally, the leading companies provide a "Do Your Own" plan in which they provide the IRS-approved plan documents, while also performing essential record-keeping functions.

Embracing the digital transformation phenomenon, these change agents make it easy to embrace what is affectionately being called 21st Century Diversification. First, the individual opens an account, which typically takes a few days at most. Next, the individual moves money into the account, either with a rollover from an existing retirement account or by making contributions to the new retirement account.

Once the account is operational and funded, the individual identifies the asset they want to purchase. Finally, the individual calls the company and tell them what they would like to do. He or she can also simply write a check to make the investment.

So what kind of retirement account affords this flexibility?



The Solo 401(k)

A Solo 401(k) is a unique investment account that allows alternative investments to be held as assets, which can potentially build tax-free or tax-deferred wealth at a faster pace than traditional methods may. Awareness of these types of accounts is spotty, primarily because financial professionals either may not be aware of these options or their interest lies in selling products that typically involve stocks, bonds and mutual funds. Stocks, bonds and mutual funds are more traditional investments that are available through most brokerage firms and banks.

The Solo 401(k) may be viewed by some financial professionals as a threat since these accounts are about empowering the individual investor, providing a channel to make alternative investments. When investors self-direct, they control their own investment choices and can potentially build wealth in their accounts by investing in what they know best.

So, what are alternative investments? Some examples might include **Precious Metals, LPs & LLCs, Real Estate** (rental property, raw land, mortgage notes, tax lien certificates), **Trust Deeds** (like and unlike exchanges, contract options, building bonds), **Commercial Paper** (commodity and option exchanges, futures), and **Private Placements** (certificates

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of deposit, tangible asset deeds, foreign stock, accounts receivable). In fact, anything not deemed prohibited by Internal Revenue Code 4975 may be purchased within a Solo 401(k) or other qualified plan.

Of course, this doesn't mean individuals can't or shouldn't invest in traditional investments, too.
In fact, the private and public sector is rife with examples of how diversification (investing in both traditional and alternative investments) is an effective investment strategy. Look no further than Yale College's growing endowment for a powerful example of what can happen when a diversification strategy is embraced.

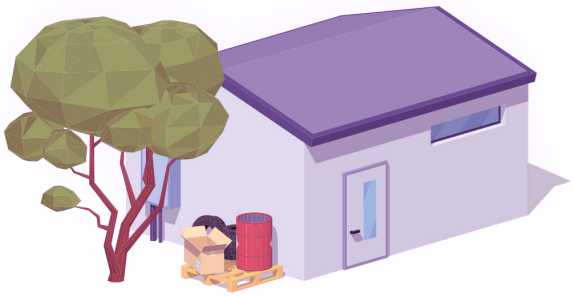
Yale's endowment earned an 11.3% investment return (net of fees) for the year ending June 30, 2017 as the value of the endowment soared to $27.2 billion.

Significantly, projected Yale's describes its asset allocation as "well-diversified." It targets a minimum allocation of 30% of the endowment to market-insensitive assets (cash, bonds and absolute return). The university further seeks to limit illiquid assets (venture capital, leveraged buyouts, real estate and natural resources) to 50% of the portfolio.

Private Businesses, Startups & Real Estate

One of the most dynamic investments the individual can make from their Solo 401(k) account is investing in a private business or a startup. The caveat with this is that the company cannot be an S-Corp. However, if investors plan on being active in the business, they must hold a minority interest. If they plan on remaining passive, they can hold unlimited interest.

The rules also allow for investing in real estate. Since the inception of Solo 401(k)s in 1974, real estate has been a viable option and a popular investment choice. A Solo 401(k) or real estate 401(k) gives an investor the freedom to invest in real estate related vehicles such as raw land, rental properties (single-family and multi-unit), commercial property, mortgage notes, tax liens, and more. Many investors find investing in real estate attractive because it is fairly easy to navigate, and the investment is secured by a tangible piece of property.



There are some unique aspects to investing in real estate from a Solo 401(k). For example, the Solo 401(k) is the owner. Therefore, any proceeds generated from the property must be paid to the Solo 401(k). For example, if the account holder leases a property, the rent payments will be deposited into the Solo 401(k), tax-free. Conversely, any expense generated by the property must be paid for by the Solo 401(k). For example, property taxes, improvement costs, and HOA fees would all be paid for from the cash inside the Solo 401(k).

There are some limitations. While the Solo 401(k) is the owner of the property, the Solo 401(k) holder and/or their disqualified parties may not use or otherwise occupy the property. The Solo 401(k)-owned real estate must be treated as an investment while it remains inside the Solo 401(k).The latter can eat into those paper profits. The last option is the single-family property. While mundane, these tend to appreciate steadily with a workload that fits between commercial and multi-family properties.
There are other intricacies associated with investing in real estate, such as the various ways the property can be purchased.

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There are three ways: they can buy 100 percent of the property; they can be a partner with other people, entities or even Solo 401(k)s; or they can obtain non-recourse loans.

It is important to note that all expenses and rental income flow through the Solo 401(k) account. With rental income, the tenant would make the rent check payable to the investor's Solo 401(k) and send it directly to the account. When expenses for the property are incurred, the account holder would contact the company and instruct it to cut a check from his or her Solo 401(k) account for a particular invoice.

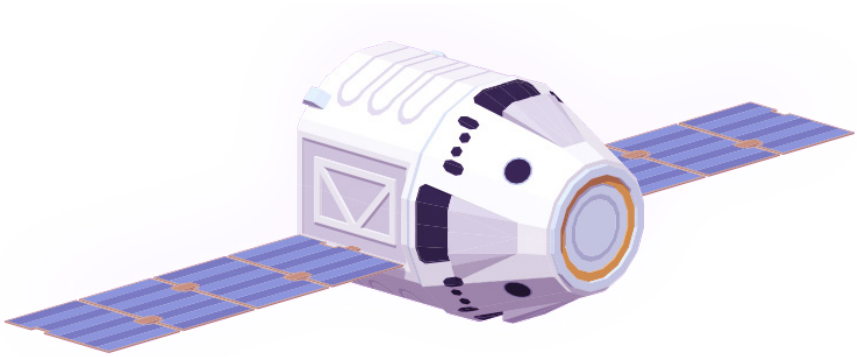
The concept of sweat equity comes into play when investing in real estate. For example, the investor must pay for any services through the Solo 401(k), and is disqualified from receiving any income or personal benefit from their Solo 401(k). The investor is unable to make repairs for no pay, because that would be considered contributing "sweat equity." Sweat equity is difficult to quantify, but also not allowed because all contributions towards an Solo 401(k) must be in cash. The investor should choose contractors to be paid through their Solo 401(k) to perform maintenance and repairs as needed.

There is some inherent flexibility when it comes to investing in real estate. An example of this comes into play if the investor can't buy the property or other investment outright.

You Have Several Options

There are several options for this:

- Partner the Solo 401(k)'s funds with personal funds. For example, the Solo 401(k) can own 50 percent with personal funds making up the other 50 percent. This would constitute tenants in common.
- The investor can also partner Solo 401(k) funds with funds that he or she has personally guaranteed, like a home equity line of credit.
- Finally, the Solo 401(k) account holder may also partner with someone else's personal or 401(k) funds.



There are limitations in what can be invested in as spelled out by Internal Revenue Code 4975. For example, life insurance and collectibles are prohibited items to purchase within a Solo 401(k). Collectibles include works of art, rugs, antiques, metals (other than gold, silver, and palladium bullion), gems, stamps, coins, alcoholic beverages, and other tangible personal property as may be defined by the Secretary of Treasury. The same code section also defines disqualified persons – certain people and entities that are deemed disqualified in terms of doing business with the investor's Solo 401(k).

The disqualified parties alluded to above include: the Solo 401(k) holder and spouse; the Solo 401(k) holder's lineal descendants and their spouses; the Solo 401(k) holders lineal ascendants; investment advisers, managers; corporations, partnerships, trusts, or estates that disqualified persons own a 50 percent or greater interest; anyone providing services to the Solo 401(k).