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Bringing real estate into your wealth strategy

From left: Adam Way, Eric Jacobs, Kevin Pitts, Dave Holland, Kevin Forbush and Brian Dewald at the Real Estate Investment Table of Professionals.

"Do It Yourself" can create rewarding results if your project is to remodel your bathroom, build your kids a treehouse or restore a classic car in your garage. But when it comes to investing in a residential rental property, DIY could lead to an unfortunate money-pit scenario that could drain your finances, ruin relationships or negatively impact your taxes.

If you want to plunge into Denver's hot residential real estate market, having proactive plans – rather than taking a blind leap of faith – is the recommendation of the panelists at Denver Business Journal's Real Estate Investment Table of Professionals who discussed "Bringing real estate into your wealth strategy." The panelists concurred that advance planning is essential for success and shouldn't be a DIY effort. They recommend using a professional team, which possesses a clear knowledge of financial, legal and tax advantages and potential implications, to help you score wins in residential real estate ownership.

The panelists included: Adam L. Way, CFP®, ChFC®, AIF®, CLU®, CLTC, Global Wealth Strategies & Associates LLC (GWS&A); Eric M. Jacobs, MBA, APMA®, AIF®, partner and director of investments at GWS&A; Dave Holland, CPA and partner, Mile High CPAs; Kevin Forbush, Esq., CPA and estate and tax planner, Forbush Legal PLLC; and Brian Dewald, licensed mortgage originator, Fairway Independent Mortgage. Kevin Pitts, Denver Business Journal publisher and market president, moderated the discussion. Hosting the event at its Cherry Creek headquarters in Denver was GWS&A, a full-service, boutique wealth management company.

Panelists stressed that real estate investment can be part of a healthy financial portfolio and can provide tax benefits. It's also possible to purchase property without a 20 percent down payment. In addition, proper planning can help prevent a myriad of legal issues in the event your investment partner dies, gets a divorce or wants to discontinue the relationship.

Q&A **Kevin Pitts: Real estate has been a hot part of Denver's economy for a while. How do you see the market?**

Brian Dewald: When you think about real estate, it's said most rich people are real estate owners and investors. Denver is a very busy city with a lot of growth and tech here. There are a lot of high-income earners coming to our neck of the woods. The market has been great for sellers but a bit trickier for buyers. Denver's one of the hot spots nationally, for sure.

Adam Way: When you're talking about investments across the board, Roth IRAs, 401ks and things of that nature can make you feel good about retirement. But, when you come home, your home is your sanctuary and where you're at peace. So, a home is an extra special way of building wealth that you can enjoy extra enjoyment out of. In addition, it is a nice alternative to more traditional types of investments.

Dave Holland: I'm also a big fan of real estate. It's an opportunity to be creative and accumulate wealth with your investable funds. It's also a great way to expose yourself to the appreciation and

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"It's nice when you can combine the legal piece with the financial planning piece, so you have a plan for when the rubber hits the road. I've seen situations where there weren't good agreements and things didn't go well." — Adam Way, left

growth of Denver. There are also tax efficiencies to real estate investing. I've grown in the actual experience of owning real estate and have seen how beneficial it is from a tax perspective and also from a cash-flow perspective.

Eric Jacobs: For many, if not most Americans, the goal at some point is to own a home. Speaking on Real Estate from an investment perspective – over time, it can become your biggest asset, along with potentially your 401k or business. The growth we've seen here in Denver can really increase the excitement surrounding real estate. It makes people more and more interested in Real Estate as an investment, rather than just a place to live. It becomes an asset you can take with you for the rest of your life.

Pitts: Talk about down payments and what it takes to get into this heated market. How do you navigate that?

Way: When you think of the standard rule being a 20 percent down payment, as a baseline, the average home in Denver costs about $550,000. You would need about $110,000 as a down payment. In addition, you would still want to keep a six-month emergency fund. Those are significant numbers to discuss! What most people don't realize is capital they already own in retirement accounts can provide for down payment dollars. Many people don't realize they can take money out of IRAs in a tax-efficient way for down-payment dollars. Some don't know how to access Roth IRA basis or use the first-time homebuyers' exemption. In some cases, you even can buy an investment property within an IRA. There are ways to come up with a down payment dollars that are eye-opening.

Dewald: It is a pretty-common misconception that you always need 20 percent to put down on a house. You can do it with a lot less than that, depending on the circumstance, which can make sense from a cash standpoint and an investment standpoint. Someone could put five percent down if they have the extra 15 percent somewhere else. You don't need a large down payment in average scenarios.

Pitts: How does the process differ for the self-employed?

Dewald: There are a lot of misconceptions. A lender can use any type of income for real estate, including documents for the IRS. There's a pretty thorough way to go through tax forms for the self-employed. It's very common for a lender to need a two-year history of self-employment. It's difficult for someone who's been self-employed for less than that. In the mortgage world, a lot comes down to experience. It's important to have an underwriting team that understands what's needed in terms of approval information. It's important to have a lender who knows what to look for and decipher tax returns. One who can go through a tax form with a fine-toothed comb and know what information is there before submitting a request for mortgage approval by an underwriter.

Holland: Having a team on your side can be very helpful. If you have a mortgage professional and tax professional who are working in silos and don't communicate with each other, they may be giving you conflicting advice. Often times, it may make sense to accelerate an expense for a self-employed person – perhaps push forward an equipment or vehicle purchase – from a tax perspective. However, because such purchases might lower your income from self-employment and could negatively impact your ability to get approved for a mortgage, you might exercise caution before incurring expenses. It makes sense to have a financial team working together on your goal, which can be critical for self-employed individuals.

Kevin Forbush: From the legal side, when we look at qualifying, underwriters will sometimes look for "vague" requirements. Your professional team, working together, can assist you in communicating with an underwriter. An attorney can say, "they're looking for this, so let's write a letter of explanation" that can help soften or justify a situation to help move the process forward. There are a lot of situations like this where the underwriter is following a checklist. Your team can

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"It's important to have the expertise to know what an underwriter will be looking for before they ask for it." — Brian Dewald, right

help you look at that checklist, expand it out and get to what they're looking for – helping avoid a stumbling block.

Dewald: It's important to have the expertise to know what an underwriter will be looking for before they ask for it. I've always been under the impression that you only have one shot to make an underwriter's opinion. So, by collaboratively having all these pieces of information together, we can have everything to give to the underwriter and have them make a decision on the first attempt, rather than them needing to come back for more information. That can be substantially beneficial.

Pitts: Can you talk about what "mapping" means and how do you use it?

Holland: Often times, a single number on a tax return may consist of various different inputs coming from various, different sources of data. It's important to document how each input is mapped into the return so that we can easily recreate the numbers on the return if questioned about the return later. Many times, accountants don't take the care and time to do that. If a tax return is scrutinized by a third party, such as a mortgage underwriter or an auditor, they may ask for more information on how a given figure on the return was calculated. Taking the time to map the inputs on the front-end and being able to provide mapping to a third party on behalf of a client can be critical in qualifying for a mortgage or avoiding headaches down the road.

Way: When working with someone like Dave, when he provides the mapping file, it can help us understand things like true and accurate debt-to-income ratios.

Pitts: Real estate tax implications can be complicated. What are some of the top considerations?

Holland: A real estate investor should have a clear understanding on how real estate is taxed prior to getting into the investment world. Key tax benefits include treating rental income as passive income, which is not subject to the 15.3 percent self-employment tax typically paid on business net income reported on Schedule C. There are other common, impactful deductions, such as mortgage interest paid and depreciation, that are often overlooked for a rental property. In some cases, rental real estate can show a tax loss while actually resulting in net positive cash flow. It's key for a potential real estate investor to know all the potential tax implications prior to investing.

Forbush: From a legal perspective, it can be good for some people to hold their real estate in a limited liability company (LLC). However, they may not know how having an LLC can affect getting a mortgage or what tax considerations go into forming an LLC. I find clients all the time who set up an LLC before talking with an attorney or a qualified CPA. It's hard to back out of that situation when they've gone down the path the wrong way. That's why it's important to have a professional team involved in advance, so they can help you decide the best option when making a real estate investment purchase. It's possible that an investor might buy a property and later transfer it into an LLC. The lawyer and accountant can then work together to structure the LLC to achieve the best tax outcome. The sequence of the steps that result in owning a property in an LLC also is important. Working together in the beginning can help prevent someone from digging themselves out of a difficult situation later.

Way: Anytime you can be really, really proactive,

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"Having a team on your side can be very helpful. If you have a mortgage professional and tax professional who are working in silos and don't communicate with each other, they may be giving you conflicting advice." — Dave Holland, left

it is a good thing. I've had clients say, "this process is easier than any other transaction I've done. Historically, it wasn't this easy 3, 5 or 10 years ago." To make a point, a lawyer like Kevin can prevent a potential legal issue from becoming a legal issue. It's much less expensive to do it that way compared to if you screw it up and you need a lawyer to fix it. That can be much more expensive and, sometimes, a lawyer can't fix the situation.

Pitts: There are expense ratios and tax consequences involved in investing. What are some of the common mistakes you see real estate investors making?

Jacobs: From an expense standpoint, many people don't understand the costs involved with what they may want to own. They don't understand potential expenses, whether it's buying property or investments inside a Roth IRA. It's important for investors to know there will be some costs involved with everything and what those costs are. If you are doing the due diligence and aren't finding the data – if things aren't transparent – that can be a cause for pause. We've come so far, as an industry, in being more transparent. I try to encourage folks to be careful of investments with commissions and up-front charges, which can eat into an investment return. It's critical for an investor to understand both what they're getting into and how to get out as well. The liquidity issue can be equally important as the return on investment.

Pitts: Should rental activity be segregated from property ownership?

Forbush: Absolutely. The main reason is rental activity is a business. There are risks involved with conducting the rental business. If you think of a rental property as the goose that lays the golden egg, you want to make sure that is not at risk. We like to wrap that activity in an LLC that can protect the property itself (the "goose") from slings and arrows of liability associated with the rental activity. There are two activities associated with rental property: being a landlord and being a property owner. Many people do both activities in the same entity, thereby failing to recognize that the biggest liability comes from being a landlord. There are a lot more things someone can get sued for a landlord, for example, refusing to rent to someone for a legally-prohibited reason. If you can move the rental activity away from the rental property, you protect the goose that's laying the golden egg. With a properly prepared LLC, the owner can help protect and isolate their property from the liability that can be associated with being a landlord.

Pitts: How do trusts play into that?

Forbush: Sometimes, trusts own either or both types of these LLCs. Often, property owners will have their living trust own the LLCs. Married couples might have separate trusts with each owning part of the LLCs. There are also times when an investor might use one or more irrevocable trusts to own the LLCs. Irrevocable trusts often have tax consequences different from revocable trusts. Trusts are often uniquely named from those who create them, so trusts can provide a degree of anonymity for their creators.

Pitts: There are a lot of things that can happen: death, disability, divorce, voluntary or involuntary terminations, bankruptcy and retirement. What is the importance of buy-sell agreements in the event one of these things occur?

Way: Many times, people get into business with one another and they think things are going to be rainbows and butterflies forever, things are going to be perfect and they're never going to run into issues. It makes sense to look at "what if" factors. For example, what if Brian and I went into a business venture together? He may love working with me, but he may not like working with my spouse. If I were to get hit by a beer truck one day, his new partner would be my spouse. He might not like that. So, we often recommend writing out our "rules of engagement," defining how my estate would get paid. As a Certified Financial Planner ™ professional, it's an absolutely mission-critical in the planning process. I want to make sure that when they meet with a business planning attorney that they're not thinking about these ideas for the very first time. I recommend that clients sit down with their spouse and discuss these situations. That way, when they meet with their attorney, they know what they'd like to do in writing well ahead of time. The estate planner can then polish those ideas into a well-oiled machine that works really well from a legal standpoint.

Forbush: You can't do these things backward. If you're in the heat of a dispute and people are disagreeing, it's important to have an agreement in place in advance. That agreement serves as a blueprint on how you're going to navigate through possible buy-sell situations. It can also help us decide how to fund things. If Dave and I own a CPA firm and I die, Dave likely does not want to become partners with my wife (she probably does not want to be partners with Dave). It may be important for us purchase life insurance on each other so Dave would have the cash to pay my wife for my interest in the firm. If we do that, we will be effectively prorating and building in the cost of our succession plan over time. My wife gets the cash for my share of the firm and Dave gets the business. Both Dave and my wife would end up getting something they need, so the plan would be a success. A buy-sell agreement should be thoughtfully laid out and funded. When you involve a planning team, you can prevent killing the goose that's laying the golden egg. When you involve a team on the front

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side, you can avoid the negative issues.

Way: It's nice when you can combine the legal piece with the financial planning piece, so you have a plan for when the rubber hits the road. I've seen situations where there weren't good agreements and things didn't go well. If a good plan was put into place, situations like these can be resolved faster. Situations (death, divorce, etc.) can be a very stressful time. By having a plan, you can get some of the stress off the plate in advance.

Pitts: How can you square liquidity needs with an investment? What are the biggest mistakes you see?

Jacobs: Whether you're talking about personal financial planning or business financial planning for a rental property, we really to encourage people to have six months of total expenses in reserves to cover all potential scenarios. Those expenses can be mortgage costs and costs to upkeep the property, anything related to that rental. We want people to have those dollars liquid but also want to see what interest can be squeezed out, just to grow that money a little bit more. From an investment risk standpoint, I'd like the dollars to be totally liquid because, in a volatile market, you don't want to go backwards and end up with less than from when you started, especially when trying to solve for potential emergency and immediate liquidity needs.

Pitts: From your specific area of expertise, please talk about some of the biggest mistake you've seen clients make in real estate.

Way: For me, it's seeing people with a lack of an emergency fund, a lack of having a well-formulated buy-sell agreement and failing to have an exit strategy. I've seen real estate situations when one partner is 38 years old and the other is 58. The 58-year-old plans to retire in two years and the younger one doesn't. They don't have a plan for the future, and they assume it's all going to work out. Not thinking about further on down the road is one of the biggest mistakes. If you want to invest in real estate in the next two years, the time is now to sit down with a Certified Financial Planner ™ professional, not a month before you want to start a transaction.

Holland: From my perspective, people aren't always educated on the tax implications of real estate. I see people taking their net income from their rental property and putting it into the wrong schedule on their tax return, which can trigger unnecessary taxes in some instance. Alternatively, they can report their rental activity on the correct part of their tax return but miss deductions by trying to do it alone without the proper education on taxation of rental real estate. They can be missing huge opportunities or exposing themselves to further scrutiny from taxing authorities because they're misreporting income or overstating expenses. Sometimes, they don't take deductions that they're entitled to take. I've seen some colossal mistakes made. The biggest single mistake I see is people not taking depreciation on a rental property, which can offset, and reduce, their gross rental income in a big way.

Forbush: Real estate can be fun and exciting, but people can get "ready, aim and fire" in the wrong order. As an attorney, I've seen people getting the steps out of order. Then the costs go up or the opportunity is lost. I want people to understand that working with a well-qualified team means there is an order to the steps and that reacting is far more expensive than being proactive. The two biggest mistakes I see are not planning in advance or failing to work with qualified people. It can kill the fun and excitement of the deal because unnecessary costs can be substantial and irreversible. We've all seen people who are do-it-yourselfers. They're very proud of what they've done until they learn how badly it can turn out. I understand people don't like paying lawyers. However, if you want to pay less in legal fees, be proactive. If you want to preserve capital, be proactive. If you want to avoid the brain damage of dealing with an underwriter, be proactive. If you want to pay less taxes, be proactive.

Way: If I were to compare the financial services space to the medical industry, most people would understand that an EMT, on average, knows less than a doctor. And a doctor is less specialized than a cardiologist. The financial world is set up in much the same way, except few people know what all the titles are. On the low end is a financial representative or advisor. People don't know if they possess the knowledge or training to work on transactions like this. You want an alphabet soup of letters behind your financial person's name. There are planners who are fiduciaries, which means they must act with your best interest in mind 100 percent of the time. There also are non-fiduciaries. It's important for someone to ask if their planner is a fiduciary. I would also note that if you have a brother-in-law who is a CPA, or someone else you love and trust, you can use them as part of your team – a company like ours can introduce other professionals as members of the team, should you have a gap.

Pitts: The group of you work as a team. However, investors may not be working with a team and want to jump into real estate. What sort of order should they follow? What's the first thing they should do if they're thinking about this?

Dewald: I would suggest they talk with a Certified Financial Planner ™ professional and their team first. They have the knowledge and can structure ideas. They can serve as the gatekeeper because they have certain knowledge and experiences on what each of us can do.

Forbush: I think the order is really important. If you have a collaborative team, they know what to do. Professionals will hand off what's needed to other members of the team at the right time. The client benefits when the team works collaboratively. I would ask a client if they have a professional team and how they work together. The client wins when we all work together.

Holland: As part of a team, it's important to know the role you play. It helps to know who's going to quarterback a financial game plan and know who's going to be specialized players. It's also a stress relief as a professional to know exactly what I'm responsible for with a client. If I'm not qualified to answer a more specialized question for a client, I know I can direct them to another member of their financial team for that different, specialized answer. It's important to know your role on your client's professional team. We all have goals and if your whole financial team is pulling together in the same direction, they can be much easier to achieve.

— Edited by Don Ireland

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MEET THE PANEL

ADAM WAY

CFP®, ChFC®, AIF®, CLU®, CLTC

Email: adam@gwsa.us

ERIC JACOBS

MBA, APMA®, AIF®

Email: eric@gwsa.us

Company: GWS&A
Address: 55 Madison Street
Suite 755, Denver, CO 80206
Phone: 720-420-4870
Web: www.gwsa.us

Adam Way and Eric Jacobs are partners at GWS&A, which is a comprehensive, boutique wealth management firm located in Denver's Cherry Creek neighborhood. Our highly credentialed staff works collaboratively serving individuals, families and businesses in Colorado and throughout the United States.

Our methods are process-focused, not product-driven, and are often described as an examination of a family or business's financial health. As fiduciaries, we examine: Retirement Strategies, Education Planning, Tax Mitigation, Emergency Savings, Liquidity, Risk Management, Legacy, and Trust & Estate Planning to create balanced holistic financial plans.

BRIAN DEWALD

Title: Licensed Mortgage Banker, NMLS: 209847
Company: Dewald and Associates at Fairway Independent Mortgage Corporation
Address: 12170 N Tejon St., unit 600
Westminster, CO 80234
Phone: 720-500-1880
Email: Dewald_group@fairwaymc.com
Web: www.dewaldloans.com

Brian is a leader in the mortgage world. It all started by fate. Brian was recruited back in 2005. Since then, he has managed to build a wonderful team, been ranked highest amongst his peers by earning the Top 1% in his field for 5 years running. In his spare time, Brian enjoys many hobbies including automobiles, cycling, music, cooking, amongst others. Brian is married to his wonderful wife, Annetta, of 19 years. They have a 16-year-old son.

KEVIN FORBUSH

Company: Forbush Legal, PLLC
Address: 902 S. Weber St.
Colorado Springs, CO 80903
Phone: 719-473-6654
Email: kevin@forbushlegal.com

A proud Air Force Judge Advocate General Corps Veteran, Kevin Forbush is both an attorney and an actively licensed CPA. His combination of legal and accounting experience makes him uniquely qualified to counsel clients on the complex issues where the law, taxes, and financial matters intersect. Kevin focuses his practice on estate planning, tax planning, asset protection and business planning. Kevin and his wife, Beth, enjoy living, working and playing along the Front Range and pursuing the Rocky Mountain lifestyle.

DAVE HOLLAND

Title: Partner
Company: Mile High CPA
Phone: 303-219-8856
Email: dave@milehighcpas.com
Web: milehighcpas.com

Dave Holland, a partner at Mile High CPAs, is a Certified Public Accountant (Colorado) and real estate investor who also holds his Series 7 and Series 66 licenses.

With a background in financial institution audits, Dave specializes in tax preparation & planning, small business consulting, process documentation, risk assessment, as well as financial information systems.

Dave is a graduate of Regis University and strives to assist clients in achieving their financial goals through tax efficiency in their personal and business finances.

MODERATOR

KEVIN PITTS

Kevin is publisher and market president of Denver Business Journal, overseeing total operations and strategy for the media company, which include content, advertising, audience, events, production and finance.