A Future Without 401(k)s: The Major Threats Facing the Conventional Retirement Model – Austin Hair (Part 2): Ep #458

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Dr. David Phelps

Dentist Freedom Blueprint with Dr. David Phelps

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Welcome to the Dentist Freedom Blueprint, a podcast about freedom—freedom from expectations of society and the traditional path to success that has been ingrained in us from our early years, I'm joined by mavericks, renegades, and non-conformers to discuss an anti-traditional path to financial freedom, freedom of time, relationships, health, and ultimately freedom of purpose. My name is Dr. David Phelps. Let's get started.

David Phelps: Hi all, David here. This week I will share the second half of a recent conversation I had with Mr. Austin Hair of Leaders Real Estate, a commercial real estate broker, lessee cohort who helps healthcare operations and platforms with their commercial real estate needs.

This week in my conversation, Austin and I went down the path of what I consider a future without 401(k)s, the major threats facing the conventional retirement model.

Hope you enjoy this conversation, see you next time.

Austin Hair: So, let's talk then, I know that you have strong opinions about 401(k)s and that sort of investing, and so they're a lot more control when it comes to real estate. So, what was your experience with the traditional kind of 401(k), Roth IRA post-retirement?

David Phelps: Well, so back in the 90s, I've been doing real estate at that point, probably for 15, 16 years — was seeing the results of that, which was a good thing.

But I also felt a little guilty because everybody else, all my other friends in dentistry were signed up with some people or financial advisors, money managers, that kind of people who were helping them get set up with their office 401(k)s.

I'm thinking, "Gosh, maybe I should be doing that." I didn't have more than 15 years of a track record and I still felt like, "Well, maybe there's a hole in my bucket somewhere." So, I jumped into that too for a few years.

And after having my own 401(k) administered by the administrators and the managers and putting that money in every year, like they tell you, and getting the tax deferral, which I get that, I'll talk about that in a minute.

But the tax deferral portion, and yes, you can have a Roth component, and I'm not negative about a Roth, and there's ways to build a Roth up. I'm just going to talk about traditional non-Roth here for a minute, the traditional tax deferral.

I did that for about three and a half, four years, and I just looked at it, and not that we had any bad market during that time, but I just realized I wasn't getting nearly the returns that I could get in real estate. So, I shut it all down. Terminated it, everybody got their money rolled over to traditional IRAs.

That's how I ended up with a traditional IRA, which I later converted over a period of some years to a Roth, and that's a strategy I'll come back to in a minute. For those who have 401(k)s or traditional qualified retirement accounts, I'm not saying it's a bad thing.

Because again, I got sucked into it and most people do because it's all about, "Well, I got to save taxes, I got to save taxes. I'm making money now and darn it, I want to pay taxes."

So, your CPA unintentionally … or well, I guess intentionally, but not meaning to give you bad advice, because the standard advice is what everybody's going to give you; do tax deferral. Because you got the compound effect, you're not paying taxes every year. But here's the downside … there's several downsides.

One, you're locking up your money in that qualified account, simple, traditional Roth 401(k) until you're 59 and a half. You can't take it back out. So, you've already said, "Well, I'm not going to retire until I'm 59 and a half."

I have people in Freedom Founders who are at age 42 who have done really well and actually taken some exit with a DSO or taking some multiple and they've got some good money, but they've got so much that's still locked up in a 401(k). They can't touch it without taking a big hit on the penalty.

So, the penalty is 10%. I mean, you could do it. There's a mathematical reason you could look at it, do it. But see, I think if you're an entrepreneur, which I would still classify most dentists who go into business as to be entrepreneurial, I mean, that's why a lot of people do it. Not everybody wants to be an owner, I get that. And that's fine.

For those who want to be owners, you go do that because you want to have some control over your business, your practice, how you treat people, the whole thing. I mean, that's kind of the

fun, the challenge of it. Then why don't you want to do the same thing with your money outside of your practice?

And I get the same puzzle, look, well, because that's why you have a 401(k), that’s why … okay. But if you want to be in control of your own future, don't you want to be in control of your finances. “Well, it's too hard. I don't have time.” Well, you do if you want to make it a priority. So, that's one downside.

Secondly, let's think about tax rates. Just between you and I, I mean, we could probably agree that tax rates are probably going to go higher, not lower. That's my feeling. With the debt we have in this country, with the entitlement spending, I don't see how taxes will go lower, I think they will go higher.

If that's what you believe, understand that when you take withdrawals at the appropriate time from your traditional tax deferred account, those withdrawals come out and are taxed at ordinary income tax rates, ordinary income tax rates. Highest rate of tax there is. It will only stay high, go higher.

Another reason is you don't get any benefit of investing like we do in tangible assets. Your business, real estate in the growth component, we get long-term capital gains treatment, which is about half what the top rate ordinary income rate is.

So, if you own what you can, you could own real estate in your tax deferred retirement account, but you don't get any benefits of cost aggregation, bonus depreciation, capital gains, long-term capital gains treatment, you get none of that. It all gets converted to ordinary income. Just lost all that if you wanted to do that in your account.

Another reason is you're familiar with … I'm sure your listeners are familiar with the fact that with capital assets, when we die, when we pass away, our heirs get what's called a stepped-up basis. Which means that they don't have to pay tax on the gain that you had while you held the business or the real estate or the stock, or the bond, they get a stepped-up basis.

If you have that inside of your IRA, which a lot of people will have stocks, bonds, mutual funds, et cetera, that all comes out, is taxed at ordinary income, just lost the stepped-up basis completely. So, it's terrible for generational wealth transfer. Those are some of the primary reasons I don't like the tax deferred vehicles.

But as I said earlier, there's a way to make up for that, and I'll just be very quick about this. You can take your traditional and convert it to a Roth. They tried to change that rule a year ago and remove that. But you can convert to a Roth any amount you want to, and you just only have to pay the current tax on whatever you convert.

You convert to a Roth, now you have that money in an account today at least, that not only is tax deferred, but also the withdrawals come out tax-free. Now, I think they're going to probably means test that in the future. So, don't load up too big, but that's one way to be better-

Austin Hair: Just meaning average it out?

David Phelps: No, means test meaning you've got so much net worth, you've got so much income, we're going to tax you to some extent on that Roth that was supposed to be tax free.

But look, that means testing everything right now. Social security just means test … I'm on Medicare — believe it or not, I'm on Medicare, it means tested. Trust me, I pay at the top level. It's not cheap, okay.

So, the better you do in life, unfortunately, we're becoming a more socialistic environment society. And I'm not saying we should be helping other people that don't, but it's wealth redistribution, and it's what it is. And it's not good in the long run. There are places where we need support, but you're going to be means tested.

So, you do really well in life, and I think a lot of the benefits … well, social security's going to get means tested, I guarantee you. I'll be able to start taking it in three years at the highest level. Sometime before I die, they're going to means test that too and I'll probably get taxed a whole bunch or they'll reduce it.

I mean, it's common Austin, just like higher tax rates. I mean, you have to be more self-sufficient than ever before and not rely on whatever the government says the rules are today, they will change them, I promise.

Austin Hair: Yeah, no, that's a good point. Alright, so specifically what we're talking about is if you are investing, you have been investing, a lot of what you talk about in your group is stop investing in these retirement accounts that you get penalized before you take it out. If you have … and let's start doing alternative investments.

Now, if you have invested a lot in them and you do want to take it out, can you convert that into a self-directed Roth IRA?

David Phelps: Yes. There's no penalty if you want to convert from, let's just say, wherever your custodian is right now, and it could be as simple as a Vanguard, a Fidelity, a Schwab, well, fine. You can move that money to a self-directed custodian, which there are a myriad in this country, which then allows you to invest.

We call self-direct into all the other alternative investments that we've been speaking about. You're not just limited to the menu of your 401(k) administrator who gives you kind of some mutual funds and things like that. You can go into alternative investments as you wish.

Now, as I said, also, you can convert to a Roth at the same time, also self-directed, but that just takes you out of the current designation of being taxed on withdrawals when you're 59 and a half, again, under current rules.

Austin Hair: Okay. So, generally when people come into your group, the first thing you guys talk about is like, “Hey, stop investing in these 401(k)s and these IRAs, hold the money and invest them in alternative assets that yes, you may object yourself to taxes, but that's really the only benefit.”

And even then, there's a lot of advantages and ways to get around paying top tax bracket because you can do cost segregations and you can do 1031 exchanges, and so yeah. Is that kind of like the gist of some of the things that you talk about?

David Phelps: That's my model. I never tell anybody what to do, I don't tell them. But yeah, we have options, the social group and the education. I let people, they make up their own mind. And most people that are part of our community, yes, in time. First few

months, six months, they're terminating (just like I did back in the 90s) their general 401(k), cash balance plan, whatever they're doing and getting control — not taking receipt, but getting control so they can self-direct it until which time after 59 and a half.

Then if they want to take distributions, they can do that. But at least they're putting it into other investments that they're feeling more comfortable with because that's really what we do. It's what I call proximity to your investments.

Being closer to your investments than Wall Street. You're separate, you don't get inside the boardrooms, you just get the financials from your financial advisor. You just kind of have to go on the whims of whatever they think.

I like to be closer to the investment. I like to see the property, know the property or at least who's managing it and that kind of thing, that's just me. And I know that's what you do as well.

I mean, you're helping people invest in real estate that is tenanted by healthcare. It's a strong marketplace. But it takes knowing somebody and understanding what that model looks like. But I just like that better from a control standpoint. Because I know I'm going to see that through ups and downs of the economy. And I think long-term, those tangible assets are going to mitigate the inflation.

I think we're going to see deflation for a few years and then we're going to see inflation for the long-term. So, we're going to have this dip, probably some deflation in assets, because we've been in a bubble.

But long-term, there's no getting out of this inflation. I think we've tipped over into that side and we're going to see inflation here on out. They have to monetize the debt and that's to inflation.

Austin Hair: And do you hold any individual stocks or no, all real estate?

David Phelps: Zero. I did some 15 some years ago, I'm completely out. That's just me. I'm not telling other people you should do that, that's just me.

Austin Hair: I have a lot of individual stock actually. Mostly real estate, but I do like holding the individuals. Like COVID was great, took a huge hit. Now, I'm getting back, close to the highs lately.

But like the whole mutual fund idea, I've heard so many bad things about them, Tony Robbins talks about it a lot. It is just like, yeah, you look at anyone, pick any one at random and it's like 95% underperform the market. So, you're essentially 5% probability that you can pick the one that outperforms the market at any one given time because it also changes.

The 5% that outperform one year might not be the same, and in fact, usually aren't the same 5, 10 years later. So, I think we do, we are in agreement about that.

Now, back to real estate, we talked a little bit … you mentioned you're doing a lot of debt financing or investing in debt funds. Can you explain why and then … well, first of all, explain what that is and then secondly, why you're doing that?

David Phelps: So, in what we call the normal retail market space, there's institutions, there's banks, institutions that do retail financing.

And especially when rates have been low, because they have been for, gosh, the last 15 years, then using banks for long-term financing makes sense.

Even today, even with higher rates, long-term financing if you buy, even at 7.5 or 8%, I mean, it can make sense if you get fixed rate and all your costs are covered, we talked about that earlier. So, that's the retail market that most people know about.

You go buy a house, you buy an office building, you're going to go to the bank to get your financing to use the leverage which is the way you acquire and build wealth. But understand that there's a whole secondary market, which I would just call private capital that's needed because the bank's institutions have what I call a buy box or lending box, it's got a criteria. They have to, they have to have criteria.

And so, there's a whole element of the marketplace out here that's not served by the institutions. So, a lot of developers, a lot of fix and flippers and people who are operators on the street in the alternative markets, they need access to private capital because it's fast, it's easier. They're not going to use private capital long, long-term because the rates are going to be higher, let's let them get in the game.

If you're making deals in a marketplace that's turning quickly where there's deals, you can't wait to go to the bank and get an appraisal and inspections and all the stuff that banks require. You want to get the property, the asset buyer-

Austin Hair: Well, waiting on bank, all the stuff.

David Phelps: Then you do what's called stabilizer. You stabilize it, means the bank, institutions want to see a tenant or a certain

occupancy if it's a multifamily or a self-storage. So, you get it stabilized and then you go refi out with the institution, take out your private capital investors.

So, there's a private capital marketplace for people like us to put our money in. And instead of owning the equity piece, the ownership piece, which is usually where we want to be, when the market's going up — when the market's going sideways or maybe going into a correction mode, I'd rather be the bank.

We could still earn double digit returns, but with a bank, it's a lot safer place to be than in the equity space because we got the margin. We never loan 100% on our property. We might loan 70, we might loan 65, we might loan 50% because we don't want to be top heavy in the equity space.

So, debt is a place to be, I think right now, much more heavily than the equity space where we've been in for the last 15 years. It's just a shifting the market. So, there's syndications and funds that focus on that very element of bringing a client account-

Austin Hair: I'm kind of thinking the same thing too, is like we saw such a quick expanse of the real estate and a lot of these assets that I can foresee a future, I'm trying to shift my thinking into probabilities rather than definitive outcomes, and just seems like there is a greater probability that we'll see a flattening of real estate increases, like a plateauing of real estate prices rather than them to continue to go up, because they just went up so high, so fast.

It's kind of like we went in and pulled some of those gains from the future into the present. And I've been thinking about these

things too, like in short-term rentals and event spaces and doing syndicating for stuff like that.

And it's like weighing the ownership of the business part of those deals versus the real estate part. And it seems like the business part has more upside right now. So, I think it's interesting that you're doing that.

So, there's so many things that we mentioned talking about, but we didn't even get to because we were real deep, which is great. So, we're kind of coming to the end of our time and this has been really fun for me, and I really enjoyed it.

And so, is there anything that you want to talk about that we didn't get a chance to talk about yet?

David Phelps: No, I think we covered a lot of topics that are probably relevant to our respective audiences. I'd go back and say, and we talked about this earlier, that healthcare, which is a lot of our audience, that is a resilient place to be as far as a business owner. That's what I call your plan A.

So, investing outside of your plan A, outside of your business, it's something we all want to and should be doing, however you do that. But I wouldn't let the carrot of some outside ventures take the place over focusing on the business aspect — your business or a similar business housed by real estate.

That's a great step into the arena of investing in real estate because again, you've got a control factor there. But as you become more sophisticated, you can through connections and access points through other people, you can expand your investments into other alternatives. Just do it step by step.

I would just caution people today about going out and doing it by themselves just because the market's been very, very kind with tailwinds to a great extent. Be cautioned, don't go do it right now by yourself, plug in with somebody.

And I'm just looking right at you Austin, who understands the markets and can help you do something in real estate that might make sense for you. And that's my only caution is just get help from people who have experience.

Austin Hair: Yeah, no, that's great advice. So, anybody listening that wants to get in touch and find out more information about what you guys do, what's a good resource for that?

David Phelps: Freedomfounders.com, I've also got a YouTube channel that I put out a lot of blog posts, video blogs. I've got a podcast, the Dentist Freedom Blueprint Podcast, which is not just focused for dentists, but I call it that.

Because I used to tell everyone, and that's my affinity group, but it's viable for anybody who's entrepreneurial and wants to learn a lot about finance investing in general. So, those will be some places to connect.

Austin Hair: Great. Okay. Well, this has been awesome. I guess, let's check back in in six months and see how our predictions faied out.

David Phelps: Let's do it. It would be fun just to just see where the market is because again, we don't know for sure. And so, it might be fun to come back and just talk about what's happened in six months and we'll project again what we think is going to happen in the next six months to see how right or wrong we are.

But yeah, there's ways to navigate any market cycle, and no one's going to be perfect at it but it's just like how do you try to thread through it without getting bumped around and shoved to the side and that's what you don't want.

Austin Hair: Yep. Well, thanks very much.

David Phelps: Austin, always a pleasure. Thank you.

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