

Invest Your IRA in Real Estate?

Success stories prove you can. But it's not for the faint of heart.

By Mary Beth Franklin

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Painful memories of the bear market and continued frustration over low interest rates have a lot of investors looking beyond stocks, bonds and mutual funds for their retirement savings. A small but growing number have discovered they can use the money in their IRAs to buy real estate -- from raw land to single-family homes to commercial buildings.

But just because you can doesn't mean you should, warns IRA expert Ed Slott of Rockville Centre, N.Y. The rules are complex, and the stakes for running afoul of them are high. A misstep can disqualify your IRA's tax-deferred status, forcing you to pay tax on its full value plus penalties if you're under age 59½. If you want to invest in real estate in your IRA, Slott suggests real estate investment trusts.

Tax expert and author Kaye Thomas in Lisle, Ill., agrees. He notes that owning property inside an IRA forfeits the traditional tax advantages of investing in real estate. "You can't deduct property taxes or mortgage interest, and you can't use depreciation," says Thomas. "When you sell the property, a traditional IRA turns profit into ordinary income rather than capital gains" (with a Roth IRA, profit would be tax-free).

Plus, your IRA must have enough spare cash to pay such property-related expenses as maintenance costs, taxes and management fees because all income must flow into the IRA and all expenses be paid out of it.

Do your homework

Still, there are plenty of success stories. If they intrigue you, be prepared for a lot of work. First, you have to find a property you want (you can't use your IRA to purchase your own residence or vacation place). Then you have to find an IRA custodian that allows real estate investments. Don't look to your local bank or mutual fund company for help -- there are only a handful of IRA custodians who do this. You can find them by searching for "real estate IRA" or "self-directed IRA" on the Web.

That's how Eddie Gant of Houston found Entrust Administration (www.iraplus.com). He transferred his \$150,000 IRA from his brokerage account to Entrust last April and used \$62,000 to purchase a run-down single-family home. He spent \$16,000 to remodel the house and sold it within the year for \$98,000. The remodeling costs came out of Gant's IRA; the profit went back in. He has since purchased three other houses with cash and estimates a minimum 50% return within one year. But Gant, 43, has a big advantage over most of us. He is a professional home remodeler.

Become a landlord

Hanneke Jacobs of Irvine, Cal., and her husband, Peter, didn't know anything about investing in real estate when they started four years ago. But as the two of them approached 50, they knew they didn't have enough money to retire. "We didn't want to end up in a trailer park," Hanneke jokes. So on the advice of a real estate agent, they used the \$100,000 in Peter's IRA as a down payment on a four-unit apartment complex. Rental income flows into the IRA, and the property has appreciated by about \$200,000.

If you buy an apartment building or commercial space, you'll need to hire a property manager to collect rent and maintain the building. Depending on the IRA custodian, you may have to pay a transaction fee every time you authorize a check to pay a plumber or your property taxes.

Financing real estate inside an IRA, like the Jacobses did, adds more complexity because an individual cannot personally guarantee a loan to an IRA, and few banks will lend money to an IRA based solely on a property's potential appreciation. If you pay cash for a property, you give up the power of leverage. On the other hand, using leverage inside an IRA can trigger an arcane tax upon sale of the property on income attributed to borrowed money.

Spread the word

Despite the complexities, the availability of commercial lending is likely to increase as more financial institutions and professional advisers learn about this investment niche, predicts Tom Anderson, president and chief executive officer of [Pensco Trust Co.](#), one of the oldest self-directed IRA custodians. Of the nearly \$3 trillion invested in IRAs, Anderson estimates that less than 1% is allocated to direct real estate investments. But he hopes to change that. "The only reason is a lack of knowledge and education," says Anderson. "Our

message is: This is a relatively unknown avenue to build wealth in your retirement account."

That's what inspired Dana and Scott Jurak of Plano, Tex. The Juraks, who are avid scuba divers, stumbled on an intriguing investment opportunity when they visited St. Croix last year: a one-acre beachfront lot for sale for \$550,000, a price they considered a steal. They made an offer on the property and spent the next few months figuring out how to buy it. With the help of Dan Cordoba of Asset Exchange Strategies (www.myrealestateira.com), the Juraks and six other family members established a limited liability corporation and used money in eight separate IRAs to buy the land.

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