

Commercial Real Estate Investing With Your IRA

by Phoebe Chongchua

A small but growing number of people are using their retirement funds to invest in commercial real estate in hopes of turning a bigger profit.

While many are becoming aware of using IRAs to invest in residential real estate, investing in commercial properties seems to be utilized by a select few. And many more only think of an IRA as being associated with stocks, bonds, and mutual funds.

Investing in everything from single family homes to raw land, to commercial buildings is permitted with certain IRAs, provided that the real estate is not being used for your own personal use, such as a vacation home or an office for your business.

But getting started in this process can seem a bit overwhelming.

Larry Dalton, 44, recently consolidated his various 401k and IRAs to what's known as a self-directed IRA. Using a company called Asset Exchange Strategies, LLC, Dalton created a Limited Liability Corporation (LLC).

According to Daniel Cordoba, principal of Asset Exchange Strategies and a certified estate advisor in Texas, there are four basic benefits to doing this.

"First we give them transaction control. This means that they don't have to go ask a custodian to write a check for them every time they need some funds. Second, they don't have to ask the custodian for permission to buy a particular asset, as long as it's not a prohibited transaction... the third thing that the LLC provides for them is litigation protection... lastly, we've built relationships with these custodians, and offer the lowest custodial fees available," Cordoba explained.

Cordoba said the custodial fee is typically less than \$190 per year to hold the asset. However, to set up the LLC, there is a one-time cost ranging from \$1,900 to \$3,000. The costs can be paid for with your IRA funds.

"So you don't really want to do this unless you have a good amount of money to invest... if you don't have that much to invest, I would say it's really too expensive to do, because obviously, you need the up-front costs," said Dalton.

"My advice would be to have \$50,000 or more to invest, and once you have that amount of money, these costs, going long term, can be more than made up with the additional returns you get from investing directly in real estate."

If you're considering this option for your IRA, here are a few questions and answers that you should be aware of before beginning. For more details visit: www.MyRealEstateIRA.com.

Is financing real estate inside an IRA more complex?

"It's a myth that it's more complex. If you use the IRA LLC, it makes it no different from any other transaction. The steps are the same. The property is titled in the IRA LLC. However, there are more things to think about if you need to also get a loan," said Cordoba.

"You go about getting the loan, but you can't use the credit of the individual; you can only use the credit of the IRA, and that gives rise to some unfavorable tax situations (unrelated business tax). If there is income, you may have to pay taxes on the part of the income that is financed by debt," said attorney Bill Leighton, who is board certified in tax law and estate planning in Texas.

"It is always best if you can buy the property outright with the IRA. If you get a loan, you should get a non-recourse loan (that is the next best situation). There is the chance of incurring unrelated business tax. [People] need to determine with their tax advisor, if this is the appropriate structure to debt finance," said Cordoba.

Can you write off interest and depreciation on your real estate investment?

"You cannot write off interest and depreciation. Instead, you are getting your tax break up front," said Cordoba. "Basically, the LLC and the IRA is a tax-exempt entity, so there is no depreciation deduction," Leighton explained.

Can you invest with several people to purchase a property?

"Yes. We shall create two entities. We'll create what we call a purchasing entity -- and that's an LLC, or another entity structure that actually goes out and purchases the property -- and then we'll have several IRA LLCs underneath that purchasing entity," Cordoba said.

"Those several entities would be partners in whatever the purchasing entity structure is," Leighton said.

Using your IRA for real estate investments is growing in popularity because of the ability to actually control a portion of your funds. But a word of caution -- make sure you research and find experts to help you, diversify your real estate portfolio and be prepared for up-front costs and fees.

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