

Sterling Trust Company

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MANAGING YOUR MONEY

Buy and sell property using retirement dollars

BY KELLI CLICK

Everyone knows the rule of thumb that you must diversify your investment portfolio to spread out your risk. But few people are aware that they can invest in real estate using money from certain individual retirement accounts, known as self-directed IRAs.

A self-directed IRA is like other IRAs in every respect, except that it allows account holders to direct their own investments. You can buy and sell investment real estate for yourself while deferring the tax consequences. And you can earn commissions helping investor clients buy and sell real estate through their self-directed IRA.

The IRS allows you to use retirement money to buy real estate in any form: raw land, condos, office buildings, and so on. Say you find a piece of undeveloped land for an excellent price. You can buy the land through your IRA and then sell it to a developer for a profit. You can also develop the land yourself, though funds for all the improvements must come from your IRA. Once you sell the property, all proceeds go back into your IRA, where the money continues to grow tax-deferred.

Properties can be bought, sold, or used as rental property in a self-directed IRA. For rentals, all maintenance and improvement costs, taxes, insurance, and property management fees must be paid from the IRA, and all rental income must go back to the IRA. But that rental income becomes part of your IRA balance and may be used to buy other types of investments, such as mutual funds, certificates of deposit, stocks, bonds, treasury securities, and even precious metals.

When an investor uses real estate in an IRA as a rental property, the custodian of the IRA usually requires the investor to appoint a property manager to collect rents, ensure payment of taxes, and maintain the property. If you're the investor, you can't manage your own investments; the custodian will require a qualified third-party manager. But there's nothing to say you can't manage the properties of investor clients you've worked with, giving you the chance to earn some income beyond your commission check.

Custodians typically require that any real estate purchased through an IRA be bought outright with no debt financing. In addition, the property must be used for investment purposes only and can't be used personally while maintained in the IRA.

The purpose of requiring free title is to protect the IRA from contractual payments that could jeopardize the IRA if those payments couldn't be met.

When your IRA has complete title to a property, you can turn around and sell the property with seller financing. The original deed held by the IRA becomes the collateral for the promissory or mortgage note. All payments by the buyers must be paid to the IRA and can be reinvested in the other investment vehicles. Once the promissory note is paid in full, the property is conveyed to the new owners.

You can even invest self-directed IRA money in a future retirement home. To do so, you'd use the property as a rental until you retired, then take a distribution of the property from the IRA at the current market value and pay any taxes before you'd be allowed to move in. Isn't that a nice bit of information to share with prospective second-home buyers?

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