

CHAPTER 7

**YES!**

# **YOU CAN INVEST IN REAL ESTATE WITH YOUR IRA!**

**THE OFFICIAL  
SELF-DIRECTED IRA INVESTORS GUIDE**



**IRAR**  
TRUST COMPANY

IRA RESOURCES, INC.

# **INTRODUCTION TO INVESTMENT STRATEGIES FOR YOUR REAL ESTATE IRA**

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Want a sneak peek at the most popular strategies for real estate IRA investors? You'll find them in this chapter. Get the lowdown on the 5 most common methods IRA investors use to buy real estate.







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## Introduction

There are more methods and strategies to invest with a self-directed IRA than you could ever imagine, and real estate investors are some of the most creative. You may not even need the full purchase price to make an investment.

Real estate IRA strategies fall into four main categories:

- 1. Direct Purchase**
- 2. Partnering**
- 3. LLC/Checkbook Control**
- 4. Non-Recourse Loan/Leveraging**

**PLUS:** We'll also cover another method of investing in real estate where you don't have to manage the property directly — **mortgage notes**.

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## Using Multiple Methods

Though each of these methods have their own separate processes, they can be mixed and matched in many, many ways. You aren't limited to just one of them. You can combine your options to maximize your investment capital. You could use an LLC IRA to make a direct purchase, find a partner AND get a non-recourse loan, and more. You aren't limited to just one strategy. Keep that in mind when reading about each method.

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## Making a Direct Purchase with Your IRA

The most common and straightforward method of buying real estate with a self-directed IRA is through a **direct purchase**. This is when your IRA buys a property using only the money available in your account. Basically, your IRA is making an all-cash purchase of real estate. This is the simplest and quickest way to fund a purchase.



A **direct purchase** is when your IRA buys a property using only the money available in your IRA.

## How Does a Direct Purchase Work?

A direct purchase is very similar to a traditional all-cash real estate purchase, except all contracts must be vested in the name of your IRA and signed by IRAR Trust on behalf of your IRA. You also need to be aware of the rules on [prohibited transactions](#) and avoid buying from or transacting with any disqualified persons.

It can be helpful to find a realtor familiar with the process. If your agent has any questions, feel free to send them our way. We'd be happy to answer their questions. If you're a real estate professional yourself, you **are** allowed to represent your IRA in a deal. However, you **can't** receive any compensation. Taking a commission is one of several transactions the [IRS prohibits](#) because it is a personal benefit to you.



### TIP:

To ensure your transaction goes off without a hitch, it's a good idea to open and fund your account as soon as you have an investment in mind.

## Due Diligence

As with any real estate investment, it's essential to [consider the investment carefully](#). Research the property, any parties involved in the deal, and your financing before committing any funds. Make sure your investment is legitimate and makes sense for your goals. We recommend consulting with a financial professional before making any major decisions about your retirement strategy.

## Income

The most important thing to remember is that all income and expenses for an IRA-owned property must be processed through the IRA. These funds must not mix with personal funds. This can have serious consequences for your IRA. Income must be deposited to your IRA Resources account and not in a personal account, or this can result in a tax penalty.

## Expenses

When you invest in real estate, you need to consider the ongoing expenses associated with buying your property. In addition, you need enough cash in the IRA account to cover expenses after the purchase.





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## Partnering Your Self-Directed IRA


If you don't have enough funds in your IRA to buy a property outright, does that mean you're out of luck? No! You've got more options for funding, one of which is partnering your IRA with one or more other investors.

### How Does Partnering Work?

When you **partner** your IRA, you're combining retirement funds to make an investment (like you would outside of any IRA). You can partner with another investor, another IRA, or even your own personal funds (on a new transaction **only**, more details about this in our [partnering chapter](#)).

When partnering, your IRA can invest in real estate without the full purchase price in the IRA, and without taking on debt. Your IRA can even partner with disqualified persons on new transactions. That isn't a prohibited transaction. So, you can combine your retirement savings with your personal funds, your spouse's personal funds or IRA, or anyone else typically not allowed.

After you buy the property, partners need to divide expenses and income based on ownership. So for example, if a husband and wife use their IRAs to partner on a condominium (with each party contributing 50%), then all future income and expenses must be split 50/50. If a utility bill comes in, the wife's IRA is responsible for 50% and the husband's IRA is responsible for the other 50%. If they get \$1000 in rent, \$500 goes to each IRA. Any emergency repairs, each IRA is responsible for half.



**Many IRA investors don't realize they can partner their self-directed IRAs— and in some situations, even with disqualified persons!**

**This makes it a particularly useful strategy for self-directed investors. Just think of the additional opportunities!**

If you have any questions about the partnering process, give us a call. You can even ask your partners to join the call!

## **Due Diligence When Partnering Your IRA**

Make sure to fully vet your partners (as you would any investment, if not more thoroughly), and iron out all the essential details. Determine ownership percentages, payment methods and schedules, and all other details in advance. This can help you avoid difficulties down the line.



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## Using an IRA LLC to Gain Checkbook Control

Another method investors often use is called an **IRA LLC** (an LLC with no other members except the IRA). Often called a **single-member LLC** or a **checkbook IRA** (due to the increased control you get over directing IRA funds). This gives you what is known as “checkbook control”— meaning you, the IRA holder, have complete signing power over your retirement funds.

### How Does an IRA LLC Work?

Your IRA LLC can operate on its own, with you directing investments, paying expenses, and doing all reporting and recordkeeping yourself. Though you have this added control, the LLC is still owned by the IRA and is still subject to all IRA rules and regulations.

You need to form an LLC owned by your IRA. IRAR doesn't do this for you, but you can find many resources online that will (or will help you do it yourself). The requirements vary from state to state and county to county, so make sure you're meeting them for your LLC.

Once established, you'll establish a business bank account in the name of the LLC—you'll need a Tax ID Number (EIN), your Articles of Organization, and your Operating Agreement to do this. After the bank account is set up, you'll direct IRAR to send funds from your IRA to the LLC, where you will have direct control over the funds.

**Remember:** IRAR does **not** sell or create LLCs. If you want more information about forming an LLC, the IRS website will have more information, as well your local SBA.



Some companies do offer to create and manage an LLC for you, but this isn't required. These providers often claim you need an IRA LLC for self-directed IRA investing, but that's not true.



There are three main reasons investors use IRA LLCs: the speed, the cost, and the flexibility. Investors often want more control over their IRA. An IRA LLC gives it to them, along with faster access to capital. This is valuable especially to real estate investors who deal with auctions and foreclosures, because of the flexibility and access to funds. You fill out less paperwork and have fewer people to rely on, taking the control fully into your hands. Plus you pay fewer transaction fees. Additionally, if you select an IRA custodian who charges per-asset (Like IRAR Trust Company), you end up saving more on annual fees, because no matter how many assets the LLC owns, you're charged for one LLC asset.

However, that control also means there's less oversight, and you're responsible for any recording and reporting requirements, including tax filings.

### **Due Diligence With an IRA LLC**

With all these advantages come additional risks and requirements. Costs for an LLC vary from state to state, with some being more expensive than others. Sometimes there may be additional tax obligations. You are also responsible for all recordkeeping, valuation, IRS reporting, and compliance for the LLC. Keep that in mind when deciding on a strategy.

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## Non-Recourse Loan & Leveraging

Another method for additional capital: Your IRA can get a loan. This is a different type of loan than you would get personally if you were buying a house. Your IRA needs a non-recourse loan.

### How Do Non-Recourse Loans Work?

The difference between a traditional mortgage and a non-recourse loan is that you aren't personally guaranteeing the loan. This means that the lender doesn't consider your income or credit score as part of the qualification process and they don't have any recourse against you. The IRA account holder is not personally liable for repayment of the loan.

With an IRA loan, the loan is in the name of the IRA (not you personally), with the property as the only collateral in event of default or nonpayment. So, for recourse, the lender can only seize the property. They can't go after additional IRAs or personal assets. To make up for this, generally the loan-to-value (LTV) ratios are a little lower than most mortgages.

You can extend the value of your retirement savings by using leverage to invest, just like in traditional real estate investing. Maybe you don't quite have the full purchase price in your IRA, or you are investing in a high cost of living area, or just want to spread your savings across multiple investments, a non-recourse loan can help you do it.

### List of Non-Recourse Lenders

IRAR Trust Company works with lenders nationwide and has a list of lenders who have worked with our clients in the past. Give us a call and we'd be happy to provide the list and answer any questions you may have.



## Due Diligence with a Non-Recourse Loan

No matter who your loan is through —be it a bank, firm, or private lender—you'll need to carefully review the terms and conditions to ensure it's a sound investment. Not only checking for a “bad deal”, but also making sure there are no prohibited transactions. We'll review your paperwork, but you can save yourself a lot of time by rejecting any terms that would get the loan rejected by IRAR in advance.

## Take UDFI into Consideration

If you decide to get a non-recourse loan, you will need to take Unrelated Debt Financed Income (UDFI) into consideration (discussed in more depth in a [later chapter](#)). When your IRA owns real estate that has a mortgage (considered debt-financed), the income is taxable to the IRA in the form of UDFI. The amount of income included is proportionate to the debt on the property. Your IRA is only taxed on the income proportionate to the amount that is debt financed and not the entire amount of income.





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## Investing with Mortgage Notes in an IRA

A **mortgage note**, also known as a real estate note, is a promise to pay guaranteed by physical property. Essentially, it's a loan, a way to extend credit with exact terms outlined in the note itself and real estate as the collateral. If the borrower doesn't meet the terms of the note, there are consequences, as spelled out in the note (such as late fees, default, or seizure of collateral). Called a **deed of trust** in some states, this is a form of private financing. Instead of borrowing through the bank, the borrower repays the lender directly.

### How Do Mortgage Notes Work?

Formally called a **promissory note secured by real property**, these are promissory notes backed by a Deed of Trust. This is a document that places a lien against the property once it has been recorded at the local county office. So, instead of buying real estate through a direct purchase, investors are loaning money from their IRA to another individual so that person can buy a property—essentially acting as the bank. But in this case, since it's secured by real estate, if the borrower defaults on the loan the IRA can foreclose on the property.

Terms of the note vary, but they generally outline things like mortgage type (fixed or variable, for example), principal amount, repayment schedule, interest rates, and what happens in case of default.

#### More Than One Lender

Sometimes there is more than one lender on a note. The first lender, as the name suggests, is the first to be paid back. In case of default, subordinate lenders are repaid after the lender in first position receives the full payoff. In addition to lending directly from your self-directed IRA, your IRA can buy notes from brokers or private parties.

### Due Diligence with a Mortgage Note

When investing with mortgage notes, your own due diligence is extremely important. Though you do have recourse in the case of non-payment (seizure of the property), that doesn't guarantee the asset has been well-maintained or retained its value, and there are costs involved in claiming ownership. If you investigate the buyer and the property heavily before investing, you increase your chances of a fruitful investment.



## In a Nutshell

There are a number of strategies and ways to structure your IRA's real estate investment. Even if you don't have the full purchase amount, you aren't out of luck. You just need to consider your options.

Want a method of investing in real estate that's a little more hands-off? See our chapter on [mortgage notes](#).



## READY FOR THE NEXT CHAPTER?

### CHAPTER 8:

Step-By-Step:  
Direct Purchase of  
Property with Your  
Self-Directed IRA