

## How to Invest in Shopping Centers with self-directed IRA Funds as a Down Payment Financing Tips You Don't Find in Books about Self-directed IRA

By David Tran &  
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Sunny Doe has been working as an Engineer in the Bay Area for more than 15 years. Over the years, he contributed to his company's 401K plan and has accumulated over \$350K in his IRA rollover account. While it is very convenient to invest in stocks market, he noticed that the returns on the mutual funds in his IRA account are underperforming. As he grows older, Sunny faces the reality that his gray hair is not his asset but rather his liability in the high-tech field. He is also concerned about the volatility of the stock market. On a day the market is doing well, Sunny enjoys checking the balance of his account several times. On a bad day, he just feels depressed. The recent scandals about backdating stock options, restating financial results and Enron also shook his confidence in public corporations.

After learning that he can use money from a self-directed IRA to invest in real estate, he is motivated as he has been successful in real estate investment where he has more comfort and control. Learning that 44% of net worth per capita in the US is in real estate, he knows he is in the right direction. As he researches more, he learns he can use money from a self-directed IRA account as a down payment. But the IRS precludes any personal guarantee for the loan. This guarantee is a major re-

striction because all residential lenders require it. Non-recourse commercial loans in which the property itself is the only collateral do not require this personal guarantee. However, the lenders require borrowers to sign carve-outs guarantee to cover losses due to fraud or environmental contamination. This carve-outs guarantee is a gray area as no one knows for sure if the IRS considers it a kind of personal guarantee. So it is best to avoid signing this "carve-outs" guarantee if possible. In addition, most non-recourse commercial lenders are not familiar with loaning money to a self-directed IRA account with no social security number or federal tax ID as the borrowing entity. So they are somewhat hesitant in lending money especially when the self-directed IRA account is the only borrowing entity of the property. The so-called self-directed IRA and hard-money lenders that do not require the personal and carve-outs guarantees literally charge an arm and a leg, e.g. 8% to 12% interest for the loan. So, getting financing at a low rate seems to be the trickiest part. Having lived in the US of A for a long time, he knows: if there is a demand, then there must be a supply somewhere.

### What is a self-directed IRA?

In 1974, Congress enacted The Employee Retirement Income Security Act (ERISA) which established IRA's to give us the

freedom to make our own Individual Retirement Arrangement or IRA. ERISA allows you to open an IRA account and control the investment of your money. It did not state that you have to invest in stocks, bonds, or mutual funds. Most IRA companies choose to focus on stocks and mutual funds because it makes good business sense for them. It's kind of like if you go to McDonald's, you won't be able to get Sushi. So if you want to have more investment choices besides stocks and mutual funds, you have to use a service of a self-directed IRA company. Once you open a self-directed IRA account, you can use the money to invest in stocks, bonds, mutual funds, real estate, mortgage notes, businesses, precious metals and other assets.

### Self-directed IRA Companies

Below are some of the companies that offer self-directed IRA accounts. They are listed in alphabetical order. The authors do not endorse any companies.

- Equity Trust Company, (440) 323-5491, [www.trustetc.com](http://www.trustetc.com).
- IRA123, (888) 808-7687, [www.ira123.com](http://www.ira123.com).
- IRA Services, (650) 593-2221, [www.iraservices.com](http://www.iraservices.com).
- My Real Estate IRA, (866) 683-5228, [www.myrealestateira.com](http://www.myrealestateira.com)
- Pensco Trust, (866) 818-4472, [www.penscotrust.com](http://www.penscotrust.com).



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When you contact these companies for information about their fees, they normally provide a service menu and associated fees. Some are based on the size of the assets, some are based on the services you need.

There are 3 kinds of self-directed IRA companies. You need to know this to understand how they operate.

1. **Custodian:** this company holds the assets on your behalf and executes your instructions. It is normally a bank or entity approved by the IRS to hold the self-directed IRA assets.
2. **Trustee:** this company just holds the self-directed IRA assets. It's normally a bank.
3. **Administrator:** this company just does the paper work. It normally works with a trustee or a division of a bank.

#### What are some prohibited transactions or restrictions of a self-directed IRA?

1. You are not permitted to buy or sell a property between your IRA account and yourself, or your spouse, or your direct ascendants or descendant.
2. An IRA owner is not permitted to commingle self-directed IRA funds with his personal funds. However, the IRS allows an IRA owner to use personal funds to pay for incidental fees, e.g. closing costs.

#### Financing for Properties with self-directed IRA Funds

## Commercial Real Estate Investment Club FREE Membership

#### Examples of Discussion topics

1. How to get started
2. Property Management tips
3. 1031 Exchange Information
4. Funding for commercial properties with lowest rates
5. Conduit vs. Portfolio Loan
6. Property Analysis
7. Forming LLC to take title
8. Taxes & Asset Protection
9. Opportunities in all 50 states
10. Real Estate Syndication & Partnership
11. Using IRA fund to invest

To sign up, please email to [creic@efundingcom.com](mailto:creic@efundingcom.com).

Sunny has several financing options:

1. **Buy in cash:** this is the easiest and most straightforward way to invest with fund from a self-directed IRA. However, this puts a major restriction on size of his investment properties. Besides, Sunny loves the idea of using someone else's money to make money.
2. **Get seller to finance:** this may work out. However, most sellers prefer to get cash for their properties. The seller who agree to provide financing probably had a problem selling the property. And if so, there may be something wrong with the property.
3. **Borrow money from a "self-directed IRA" or hard-money lender:** these lenders charge very high interest rates, 8% to 12%. Sunny has a major problem with this kind of interest rate. The banks will end up keeping all of the profits!
4. **Invest in syndicated properties:** Sunny buys a commercial retail property together with other investors. All the co-owners apply for one non-recourse loan. As long as he owns less than 20-30% of the property (this limit is set by individual lender), the lender does not require him to sign any guarantee. This will satisfy the IRS restriction on personal guar-

antees. Sunny pays the lowest interest rate and can maximize leverage in the best properties. This is the best option for self-directed IRA investors as they co-own a better property at the lowest interest rate. Please refer to the article "What Investors Should Know about Real Estate Syndication" published by the same authors.

**Income Tax:** Assuming Sunny deposits 25% and borrows 75% of the money to buy the property then 25% of the income will be taxed deferred. This cash flow will go back to his self-directed IRA account. The other 75% of the income attributable to the debt is subject to income tax called Unrelated Business Income Tax or UBIT tax at the trust rate. All of the rental expenses and depreciation are deductible from income. In addition, the first \$1,000 of income is exempt from UBIT tax. When the property is sold, the IRA may avoid UBIT and capital gains tax if the debt had been paid off by principal payment at least one year before the sale.

#### Title to the property

His self-directed IRA account, not Sunny Doe, must be on title to the property. For example if he has a self-directed IRA account with Pensco Trust, he must take title as "Pensco Trust FBO (For the Benefit Of) Sunny

Doe's IRA".

**The Happy Ending:** The syndicator suggests Sunny to consider investing with 4 other non-IRA investors in a \$7.9M, 2-year old, 30,900 SF, 12-tenant, and 100% NNN leased upscale shopping center in Lawrenceville, which is a fast growing and prosperous city in the suburb of Atlanta, Georgia. The property is located in front of a Walmart Supercenter; so, he knows it's in a prime location. He also knows this shopping center is an ideal and safe property for his self-directed IRA due to its strong positive cash flow and long term leases compared to single-family residence. The property has a \$6M non-recourse loan at a below market rate of 5.6% through 2016. So while the cap rate is respectable at 7.25%, the cash on cash return is over 9% because the interest rate is so low. After reviewing the brochure and financial information of the property, he signs the subscription agreement to move forward with the investment. Since Sunny owns less than 20% of the property, he does not have to sign any guarantees. And this satisfies the requirement from the IRS.

**Note: Information deemed reliable but not guarantee to be accurate.**

## 2 Free Seminars

1. How to maximize cash flow with 1031 tax-deferred exchange.
2. How to invest in commercial real estate for retirement income.

Please call Maria at 408-288-5500 to for schedules & reservation.

"At first I was a little skeptical coming to David's seminar. But in 2 hours, I learned more about Commercial Real Estate Investing than I have from books or other investment programs."

Michael Cuthrell