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Banking on it

More IRA investors are taking control of their retirement funds -- and chasing their real estate dreams.

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IF your retirement garden — specifically your individual retirement account or IRA — hasn't been growing fast enough to meet your future retirement needs, you might want to join a club of contrarians: those who have decided to take matters into their own hands. Literally.

Self-directed IRAs are billed as "putting the 'I' back in IRA." They let individuals determine what, when and where to invest their retirement money. And they are catching on — in no small part thanks to the stock market's volatility and the real estate market's recent riches.

Real estate has always been permitted in IRAs, but few people know about this option. Financial institutions — mutual funds, stock brokerages, banks — are typically where IRAs are held. But investments in other things, most notably real estate, are fully permissible under the Employee Retirement Income Security Act of 1974. It prohibits retirement plans from investing in just two types of investments — life insurance contracts and collectibles. Everything else is fair game.

But ERISA or no, the other thing standing in your way may be your employer. If your IRA is held in a company plan through your job, the plan's guidelines may specify what type of investments can be made — and real estate is rarely among them. If this is the case, establishing a self-directed IRA isn't an option until you and your employer part ways. Once you leave, no matter the reason, you can roll over the funds in your IRA and 401(k) to a self-directed IRA.

It is estimated that only about 4% of America's retirement funds are held in nontraditional accounts, including IRAs invested in real estate. But the trend, experts agree, is toward more money being funneled into these little-known, little-used, self-directed IRAs.

Although investors use self-directed IRAs for a variety of investments, among nontraditional accounts, real estate is by far the most popular.

It certainly was the motivation for Anthony Moreno, 56, of Oceanside, Calif., to establish his self-directed IRA.

Moreno retired in July 2005 after working more than 24 years as a nuclear computer technician at San Onofre Nuclear Generating Station. When he left Southern California Edison's employment, he initially left his pension and 401(k) with the company — primarily because he didn't know what else to do with it, he said. But concerns about a low rate of return and a lifelong desire to own international real estate led him to research self-directed IRAs with the idea of putting his money into real estate. Opening one simply made sense for him, he said.

Now Moreno is in escrow on a pristine 68-acre private island 300 yards off of Roatán Island in the Caribbean Honduras. It was listed at \$850,000, and he plans to develop a day resort on it, ferrying cruise-ship passengers by private speedboat to his island. Carnival Cruise Line is building a \$50-million terminal at Roatán Island that will be able to accommodate two mega-ships and 7,000 passengers a day, and Moreno plans to tap into this burgeoning tourist market.

Moreno's self-directed IRA was set up by Guidant Financial Group, which specializes in facilitating real estate investments using an IRA.

"I don't see it as gambling," Moreno said of investing his retirement funds in this venture, although he acknowledges that "conventional thinking would probably view this as very risky for someone of my age" and that "there are many 'safer' investments which I could have chosen." But, he added, none of those other investments had "the potential for making my dreams come true."

"I don't know of anybody who ever realized a dream by allowing their fears to prevent them from giving it their best shot. Regardless of the outcome, I will never regret going for my dream. If I hadn't tried, I would have always wondered: What might have been?"

As romantic as the idea of buying your own island sounds, many caution that real estate purchases made through self-directed IRAs aren't the answer to everyone's investment goals. Experts, such as Jeff Nabler of the IRA Assn. of America, strongly urge people to consult a professional advisor before moving their money into one.

For one thing, the tax laws concerning self-directed IRAs are complicated — and likely beyond a layman's interpretation. Mistakes can be costly; early withdrawal penalties may be imposed if funds are misused.

The Internal Revenue Code 4975 defines what are prohibited transactions for IRAs, said David Nilssen, chief executive of Guidant Financial Group, a Washington-based company that he says is rolling over about 200 accounts each month. Basically, any investment the IRA participates in must be for the exclusive benefit of the IRA, Nilssen said.

For instance, you can't use your IRA to buy a home for your mother to rent because there might be a conflict of interest to act in the best interest of the

IRA (eviction) should Mom fail to make the rent payments.

For the same "exclusive-benefit" reason, self-directed IRAs cannot be used to purchase a principal residence or a vacation home. They can be used to buy income property, such as land or an apartment building. The title to the property would be held by a custodian, who acts as a trustee for the account and does not offer investment advice but functions essentially as a conduit for your wishes as they relate to buying and selling. The custodian would collect rent checks, pay the mortgage and taxes and handle the other financial aspects of your ownership — for a fee.

The fees vary, and investors are advised to check them carefully and do some price-comparison shopping before moving IRA money from a traditional fund to a self-directed one.

In the last seven years, Guidant's Nilssen said, the self-directed IRA industry has "exploded." Before 2000, "investors couldn't justify leaving the stock market because it was performing too well," Nilssen said. "The industry has more than doubled since that time."

Self-directed IRAs can produce great returns, Nilssen said, but he too cautioned that there are specific guidelines an investor must adhere to. "This is why we recommend that people not try to structure these investments themselves without the help of a qualified professional."

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- Internal Revenue Service: <http://www.irs.gov/retirement/article/0id11141300.html> <252>• Guidant Financial Group: <http://www.guidantfinancial.com> <252>• Pensco Trust Co.: <http://www.penscotrust.com/>
- IRA Resource Associates Inc.: iraresource.com/<252>• SelfDirectedIRA.org: <http://www.selfdirectedira.org/>
- Bankrate.com: <http://www.bankrate.com/brm/news/sav/20010213a.asp> and http://www.bankrate.com/brm/news/ira/20070417_real_estate_self-directed_IRA_a1.asp <252>

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