

February 29, 2016

Even with risks, more investors are giving self-directed IRAs a closer look



Jill Chodorov, an associate broker with Long & Foster, writes an occasional column about local market trends and housing issues.

The nauseating drop in the value of my retirement accounts in the last month got me thinking. Why can't I invest my retirement funds in what I know and understand?

I know real estate. I have been investing in real estate and servicing clients as a licensed real estate agent for two decades.

I don't know the stock market.

Every year at tax time, I dutifully deposit the allowable contribution into my Individual Retirement Account (IRA) to lower my income tax liability. And every year I repeat the annual glassy-eyed review of the cryptic stats and financials of the funds in which I invest.

So I launched a quest to devise a new investing strategy for myself, and I learned that there is a little-known investment vehicle that would allow me to invest my retirement funds in what I know best — it is called a self-directed IRA (SDIRA).

A SDIRA allows alternative investments using your retirement savings. Real estate is an example of an alternative investment.

Just as Fidelity or TIAA-CREF are custodians of IRAs for investing in traditional products, such as funds, stock and bonds, there are a handful of custodians of SDIRAs.

“This is not a get-rich-quick scheme,” said John Paul Ruiz, director of professional development of the Entrust Group. “It is a legal alternative for investing your retirement funds.”

The Entrust Group is a custodian of SDIRAs.

“Self-directed IRAs are not for everyone,” Ruiz said. “It is best for those who know real estate or have a real estate expert to guide them.”

I pass that test. I live, eat and breathe real estate everyday.

According to Ruiz, you also need an attorney, CPA or financial planner who is fully educated and experienced in the IRS rules for SDIRAs, including record keeping, qualified transactions and distributions — to name a few.

“I would not have a practice if people didn’t mess this up,” said Thomas Kolb, an employee benefits attorney in Washington.

“People want to invest in all sorts of things but they can’t get their hands on money to do the deal,” Kolb said. “Using retirement funds is perfectly legal, if done the right way.”

Kolb said the biggest takeaway he can offer is “handle with care.”

SDIRAs come with many rules. It must be held at a custodian. The legal title of the real estate must be in the name of the SDIRA. All expenses on the property need to be paid from the SDIRA, and all income from rent or sale of the property must stay in the SDIRA.

In addition, there are many prohibited transactions. For example, the property cannot be for your own use or that of a family member. And you can’t buy the property from yourself with your SDIRA.

There are other drawbacks to SDIRAs.

The North American Securities Administrators Association (NASAA) released an “informed investor advisory” about the risks and rewards of SDIRAs on its website.

“Occasionally, an investor is approached by a promoter offering an investment opportunity,” the advisory says. “Fraud promoters can deceive investors into believing that their investments are legitimate. “

A third-party custodian does not research or perform due diligence reviews for clients, the advisory warns.

“It’s my impression that the IRS has very few agents that focus on IRA enforcement,” said Kolb.

On the upside, NASAA notes that “a self-directed IRA means you, the customer, have complete decision-making power on your investments. Unlike a stock, bond or mutual fund, where others either manage or control the investment, you are in total control of calling the shots.”

That is a compelling reason to use SDIRAs, in my opinion. If you have seen the movie “The Big Short,” you may have realized how little any of us know about the Wall Street game, except for Wall Street.

“The ideal investor is someone that has knowledge in a certain area and can utilize that knowledge to grow their IRA account,” said Mick Hersh, COO of STC, Inc. in Hagerstown, Md., an administrator of SDIRAs.

“You can invest in what you know and still get the tax advantages of a traditional IRA,” Hersh said.

All SDIRA custodians charge fees, just like the custodians of traditional IRAs. “Some custodians charge by transaction, and some charge an annual fee based upon the value of assets in the SDIRA,” Hersh said. If the property is rented, a transaction would include each time you deposit rent or pay an expense on the property.

“In this case, it may be best to pay an annual fee,” Hersh said.

Do many people know about SDIRAs? Or am I stepping out on the cutting edge?

“Very few people know this is an option,” said Peggy Cramer, vice president of communications for Pensco Trust Company, another custodian of SDIRAs. “Only 2 percent of the \$7.3 trillion invested in IRAs are in SDIRAs.”

SDIRAs are becoming more popular, however.

“Self-directed IRAs are growing by 21 percent year-over-year and investing in real estate is most common,” Cramer said.

Some other allowable investments in a SDIRA include mortgage notes, tax liens, precious metals and private placement loans.

“I saw an article about it 10 years ago in Realtor Magazine,” said Vincent Hurteau, principal broker of Continental Properties in Washington, when asked how he first learned about SDIRAs. “Enron was infamous at the time.”

Hurteau was concerned about his retirement funds, so he rolled over most of his traditional IRA funds into a SDIRA with which he has purchased real estate.