STRATA
TRUST COMPANY

INVESTING IN REAL ESTATE WITH A SELF-DIRECTED IRA

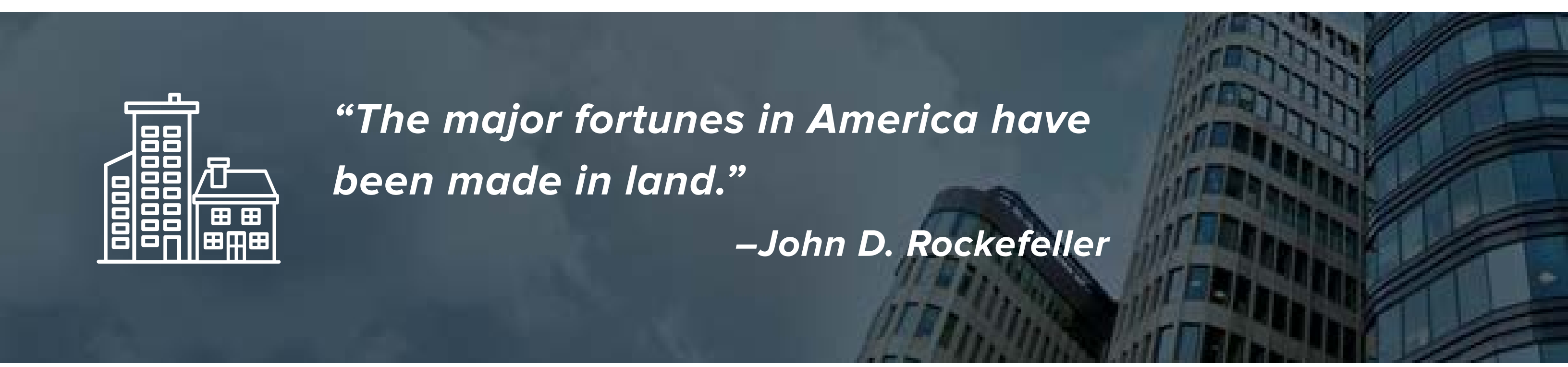
GETTING STARTED

When people think of their IRA they often think that their investments must be made in bank CDs, the stock market or mutual funds. However, this is not the case. In fact, Section 408 of the Internal Revenue Code covers the federal regulations involving individual retirement accounts (IRAs), and it only prohibits an IRA from investing in life insurance and certain collectibles (stamps, gems, etc.). Beyond this, investors can choose from a wide array of investments, including real estate, as long as they follow the federal rules and the custodian's processes.

Earnings and appreciation from real estate property are tax-deferred (if held in a Traditional IRA) or tax-free (if held in a Roth IRA), so income taxes would generally be paid later when you're in a lower income-tax bracket. Because of this, there are multiple investment strategies that can be used, such as a "buy-and-hold" strategy or "flip and sell." The process for using a self-directed IRA to invest in real estate requires preparation. The investor needs to fully understand the investment they are making along with the requirements involved when investing in real estate through an IRA.

What types of real estate investment properties can my IRA purchase?

- Vacant lots
- Raw land and acreage (improved or unimproved)
- Single family or multi-unit homes
- Income-producing properties such as rental houses, apartments, townhomes or condominiums
- Commercial properties
- Foreclosure property (if the property has already been foreclosed upon)



Investing in real estate with your self-directed IRA is not that different from a personal real estate transaction. However, there are important rules and processes that you must follow to do it right. By following the guidelines below when investing in real estate with a self-directed IRA, you can be on your way to building wealth for your retirement portfolio.

As always, investors considering a real estate purchase for an IRA are urged to seek advice from their tax or legal advisor.

What are the types of real estate holdings that may not be purchased through an IRA?

- Mobile homes (unless affixed to property)
- Timeshares
- Foreign real estate*
- Property purchased through an auction or tax sale*

*May be allowed by other custodians

REASONS TO INVEST WITH AN IRA

With uncertainty in today's financial markets, perhaps you are looking for an investment that has no correlation to Wall Street. After all, America's oldest and wealthiest families have created wealth through real estate. With a self-directed IRA, you can use your expertise to build wealth, tax-deferred or even tax-free, by investing in real estate.

DOING YOUR HOMEWORK

Find an IRA custodian, not an IRA administrator.

First, do your homework by learning the differences between an IRA custodian, administrator and facilitator. IRA custodians are typically banks or trust companies and are regulated by state or federal banking authorities. Administrators and facilitators, on the other hand, are not directly regulated, and using one may pose unnecessary risks for your hard-earned retirement assets.

To find the best IRA custodian for you, start by comparing the fees charged and ask about the company's experience in holding real estate. Next look at the level of service provided to evaluate whether this custodian would be able to handle multiple transactions and whether you are readily able to speak with a client service representative when you call. IRA custodians that hold directly owned real estate will most likely have a process outlined on a checklist or guide that shows the documents they need to receive in advance of your real estate transaction to determine if the investment is administratively feasible. Make sure you review and follow the outlined process.

Get the purchaser name right from the start.

Once you identify the property and are ready to submit an offer, the offer must identify the named purchaser as your IRA custodian for benefit of your IRA (i.e., STRATA Trust Company Custodian FBO John Doe IRA). Likewise, the contract and all other documents must reflect the same named purchaser. Bottom line, the transaction must show it was intended to be an IRA investment from the very start. Additionally, your down payment must be paid by your IRA custodian from your IRA funds. When a real estate property is contracted, the IRA account holder is generally required to sign the purchase agreement and closing documents as "read and approved by (your name)" before the custodian will sign and release the funds to the title company.

Allow adequate time and expect to be involved.

Directly owned real estate investments require time and your involvement. Investors should consider the timeline for opening and funding an IRA, which takes about 2-4 weeks to open an account and fund with a direct transfer, rollover and/or contribution (within the federal guidelines). Once the property is purchased by your IRA custodian, you must forward and direct any expenses, including property taxes, to be paid. Real estate may not be a good choice for an investor who does not have the time or desire to stay involved. An investor should learn as much as possible and prepare well before starting the investment process.

How does purchasing and maintaining real estate in a retirement account differ from traditional property investments?

- Expenses must be paid by the IRA, and any revenue must flow directly to the IRA
- Maintenance, repairs or improvements must be handled by a third party

For income-producing property, you must hire an unrelated third-party property manager.

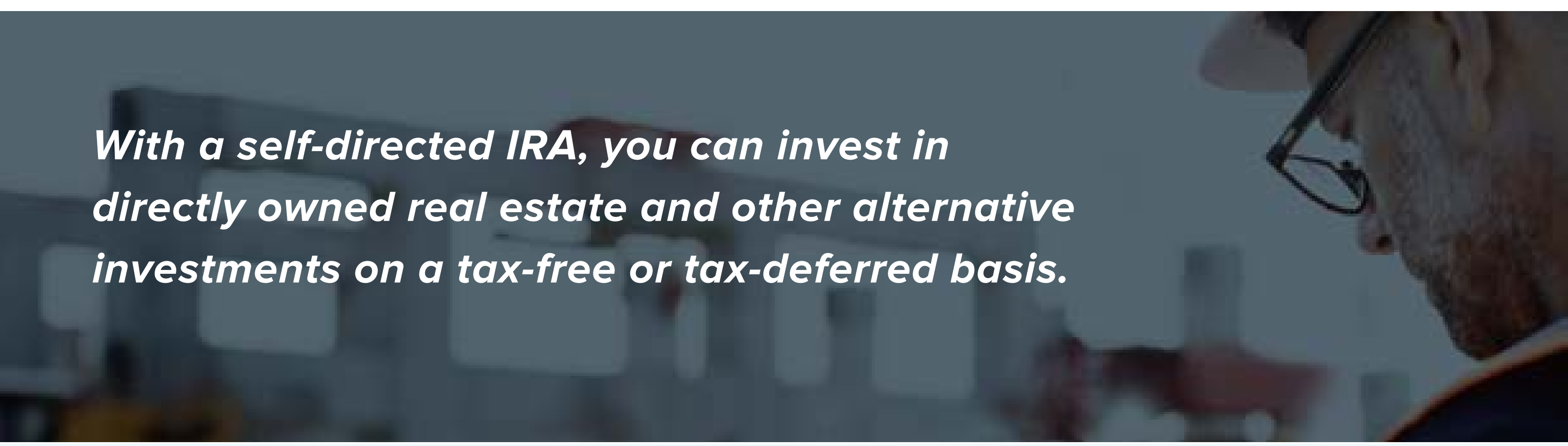
Finding tenants and a property manager may take time and effort, but a third-party property manager is needed to help navigate the day-to-day duties of owning an income-producing property. The property manager will need to collect rental income, communicate with tenants and periodically forward the rental income to your IRA to help keep the transaction compliant with the Prohibited Transaction rules.

Pay all expenses with your IRA funds—including property taxes, insurance, appraisals, homeowner association dues, maintenance, improvements and repairs.

The handling of real estate expenses often triggers the most issues when real estate is held in an IRA. First, every real-estate-related expense must be paid by the IRA, including any earnest money deposit. You may not pay these expenses out of pocket and expect to have your IRA reimburse you. Your IRA custodian will pay these directly upon receiving your instruction. Second, be sure to leave sufficient cash reserves available in the IRA to cover these expenses. With real estate, you need to plan accordingly to make sure that your IRA will have sufficient funds needed to pay all expenses involved with owning the property.

Make sure any property improvements are made by a third party. (No sweat equity)

If you perform any work to improve or repair an IRA-owned real estate asset, it would be considered “sweat equity” which is a prohibited transaction according to Internal Revenue Code Section 4975. Under IRC 4975, any direct or indirect furnishing of goods, services or facilities between a plan and a disqualified person is considered a prohibited transaction. Improvements or repairs should always be



With a self-directed IRA, you can invest in directly owned real estate and other alternative investments on a tax-free or tax-deferred basis.

made by a third party, and then you can instruct your IRA custodian to remit payment of the bill. You cannot be reimbursed for work you do, often called "sweat equity," on an IRA-owned property.

AVOIDING PROBLEMS

Avoid running afoul of the Prohibited Transaction rules, or you can disqualify your entire IRA.

Internal Revenue Code Section 4975 defines a prohibited transaction as a transaction between a plan (your IRA) and a disqualified person, which includes you, your spouse, parents, grandparents or children (lineal descendants). It may also include business entities in which you hold an ownership interest or control. Surprisingly, it does not include siblings, so you may be able to engage in a transaction with a brother or sister (or your spouse's siblings) as long as you comply with all other provisions of IRC Section 4975.

You may not have any personal use or benefit from the property while it is held in your IRA.

For example, if your IRA purchases a property in a golf community, you (or your spouse or other disqualified person) may not receive a golf membership. Another example is if your IRA purchases a vacation home or condo on a beach, you may not use the property for your personal or family vacations.

Your IRA may not purchase a property that you or any disqualified person has previously owned. Likewise, you may not sell or lease an IRA-owned property to any disqualified person.

This means that you cannot use business structures to attempt to get around the Prohibited Transaction rules. If you own 50% or more of a business entity, that entity cannot buy or sell real estate to or from your IRA. The same applies to officers, directors and key employees who own 10% or more of a business structure that wants to sell property to your IRA.

Do not take constructive receipt of any cash flow distribution from the property held in your IRA.

The income generated from the property purchased must flow directly back to your IRA, so you cannot bypass the IRA and use the funds personally unless you take a distribution from your IRA. The custodian you choose to help set up your IRA must receive all income and report any distributions taken from your IRA. Deviating from this process can wipe out the tax protection granted to your IRA and lead to extensive penalties.

SUMMARY

Knowing the rules associated with owning real estate in your IRA is essential, and speaking with your legal and tax advisor is recommended so that you understand how they relate to the real estate transaction you are considering. When in doubt, check the proposed transaction with your tax professional and IRA custodian before moving forward. In a self-directed IRA, you are solely responsible for avoiding a prohibited transaction, and the penalties are steep (including disqualifying the IRA).

As a custodian, we cannot give advice about specific investments or strategies, but we can provide answers and educational resources and point out the legal issues to think about for your real estate transaction.

Because there are certain IRA rules and processes to follow when considering real estate in an IRA, there are naturally lots of questions. On the next page, we have collected the most common questions asked by novice and experienced real estate investors:

How can I invest in real estate with my IRA?

There are several ways you can approach investing in real estate with your retirement funds. Here are a few examples:

- Direct Purchase – Your IRA fully pays for the investment property and holds the title to the property. You may transfer other IRAs held with other custodians or roll over from a former employer's 401(k) or other qualified retirement plan. Some 401(k) plans may even allow participants to make an in-service rollover.

- Partner With Other Investors or Personal Funds – Your IRA can partner with other investors that invest either with IRAs or personal funds. Each investor would own an undivided interest in the property based on the amount invested by each party. You may also be able to "partner" with yourself by using your personal funds; however, you must be able to "prove" the ability to complete the investment by having other IRA accounts.

- Leverage With A Non-Recourse Note – Your IRA property can be debt-financed by borrowing money to purchase the property with a non-recourse loan. The leveraged property is held in your retirement account and your IRA must make the loan payments.

Real estate can also be structured as an equity investment through a Limited Partnership (LP) or Limited Liability Company (LLC). Please see STRATA's *Investment Direction and Checklist for Private Equity Investment* for a real estate transaction using a LP or LLC structure.

Another option is to invest in trust deeds or real estate contracts where your IRA holds a promissory note secured by the property deed. Please see STRATA's *Investment Direction and Checklist for Private Debt Investment* for a trust deed or real estate contract.

Can I personally use the property that was purchased with my IRA funds?

No, you cannot. The property is strictly for investment purposes only. You and other disqualified persons may not receive direct or indirect benefits from an asset that is owned by your IRA, even if the IRA only owns a portion of the investment.

What type of properties can I hold in my self-directed IRA? Are there any restrictions on the type of property I can purchase?

A self-directed IRA gives you the opportunity to make investment decisions in areas based on your knowledge and expertise. Your IRA can hold various investment property types including commercial buildings, raw land and acreage (improved or unimproved), vacant lots, single family or multi-unit homes, condos or townhomes, mobile homes, apartment buildings and more. Your IRA may also purchase foreclosure property as long as the property has already been foreclosed upon. You are not limited to residential real estate.

Can I buy the property from my IRA to reside in once I retire?

No, the IRS has ruled this as a prohibited transaction, so you cannot buy a property that is already owned by your IRA. However, you can take an in-kind distribution of the property by retitling the property in your name when you are ready to take a distribution of the property. If the property is held in a Traditional IRA, the fair market value of the property would be reported on IRS Form 1099-R and be includible as taxable income in the year of distribution. If the property is held in a Roth IRA, and the required 5-year holding period has been met, the property may be withdrawn tax-free.

Can the rental income from the property in my IRA flow back to me personally?

No, you may not receive direct income from an IRA-owned property; however, you can request the funds in your IRA to be sent to you as a distribution.

Do expenses like utilities, repairs, improvements, taxes and mortgage payments need to be paid from the IRA account?

Yes, any expenses from an IRA-owned property must be received and paid by the IRA. You cannot use personal funds to pay for expenses incurred by an IRA-owned property because it is prohibited by IRS Code 4975.

For income-producing property, how should the rental income be handled for an IRA-owned property?

If purchasing a property that will generate income, the income must flow back to the IRA. For this reason, a third-party property manager is often used to collect the rental income and remit it to the custodian (made payable to the IRA). You may also have the tenants make their rental check payable to the custodian directly as they make monthly rent payments.

Can I buy a house with IRA funds but use non-IRA funds to help pay for repairs or other expenses?

No, as it is considered a prohibited transaction and will violate the IRS Code 4975; however, if eligible, you can make an annual contribution to the IRA within the federal guidelines and use the contribution to pay for expenses.

Can I be the property manager on my investment property?

No, but STRATA does permit the IRA owner to receive the rental income for recordkeeping purposes and forward the actual payments received to STRATA for deposit to the IRA. The IRA owner cannot deposit the rent in any non-IRA account since this would be deemed as a distribution. In addition, the IRA owner may not receive any compensation from the profits generated from an IRA-owned property.

How long does it take to make a typical Real Estate IRA purchase?

We typically see escrow close on a simple real estate purchase in 15 to 30 days. Depending on the complexity of the transaction, your closing could take longer. There are a number of factors that must be considered when timing a real estate purchase in an IRA. Investors must have funds available in your IRA before the investment can be made. It is important to note that funding your account is heavily dependent on the custodian or plan administrator that you may be moving funds from. For this reason, it is best to have your IRA set up and funded before you start searching for a property or at least before you make an offer. Lastly, keep in mind that the initial purchase offer for the property must be made in the name of STRATA Trust Company Custodian FBO (your name) IRA.

For questions about investing in real estate with a self-directed IRA or clarification about the rules and processes, please contact us.

For more information, visit www.StrataTrust.com and our Self-Directed IRAs in Real Estate section.

ABOUT US

STRATA Trust Company has quickly catapulted to become a premier national custodian for alternative assets and non-exchange traded investments in self-directed IRAs. Formerly known as Self Directed IRA Services, Inc., STRATA has been helping investors use their retirement account funds to invest in real estate and other alternative investments since 2008. STRATA currently serves over 33,000 individuals nationwide with over $1.8 billion in assets under custody.

With offices in Waco and Austin, Texas, our team's vast experience in handling the details and complexities that real estate transactions require is unrivaled. Our seasoned team's experience in the custody of alternative assets spans over 350 years. With a well-established reputation for honesty and integrity, STRATA is committed to delivering responsive, flexible and innovative solutions.

At STRATA, we work to ensure that the highest standards for safety and soundness are met. As a subsidiary of Horizon Bank, SSB, STRATA is a Texas-chartered trust company regulated by the Texas Department of Banking, which has long set the benchmark among state banking regulators. Strict controls are in place to ensure the safety of uninvested cash, and independent auditors are retained to conduct regular audits of our operations.

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