

IRA & 401(k) Insights

About: *IRA & 401(k) Insights*

IRA & 401(k) Insights is a monthly publication. This publication is for anyone interested in self-directing their retirement funds and investing in nontraditional assets. Entrust does not give investment advice. Entrust purposely does not sell securities or other investment products.

Deadline for article consideration is the 15th of each month. To subscribe to *IRA & 401(k) Insights*, call: 888-340-8977 or email:

editor@EntrustAdmin.com

Message From the Editor

Welcome to the March 2006 issue of IRA/401(k) Insights!

In this issue, Hubert Bromma, CEO of The Entrust Group shares options with the new Roth 2006 changes. Steve Miszkowicz, Entrust Chicago, continues from last month with strategies for mortgaging real estate in your self-directed plan; Catherine Wynne, Entrust New Direction, shows us how investors can capitalize on commercial property investments in their retirement plan; J.P. Dahdah, Entrust Arizona, helps us to "put our financial house in order"; Glen Mather, Entrust Administration Services, Inc., teaches us to teach our children in "Leaving a Legacy"; Jaime Raskulinecz of Entrust Northeast looks at other investments besides real estate in your IRA or (401)k; and Dave Owens and Patrick Hagen, of 1031 Tax-Free Strategies, discuss the benefits of Tenants in Common in a retirement plan.

We know you will want to join us in October for a one of a kind conference where you will meet like minded people who are interested in securing their retirement and their financial future. We encourage you to visit our web site to learn more about this exciting conference and register early. Seating is limited!

Enjoy our March issue.

Lisa Moren, Editor

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SAVE THE DATE! Oct. 4 & 5, 2006

Entrust is hosting a client conference in Las Vegas on October 4th & 5th, 2006. This exciting event promises to be the most comprehensive educational and networking conference for investors, professionals, entrepreneurs, and clients who want to learn more about what they can invest in with a self-directed IRA, how to do it, and how to protect what you have worked so hard to achieve.

Asset Protection, the future of the retirement plans, tax strategies and more will be covered by well known, national speakers fluent in the subject. To learn more about the conference, email Yvonne Garcia at ygarcia@entrustadmin.com or visit www.entrustclientconference.com.

Mortgaging Real Estate in Your Self-Directed Retirement Plan - Part 2 - Successful Mortgage Strategies

By: Steve Miskowicz

Welcome back.

In Part 1 of our discussion we discovered what factors lenders use to determine the maximum mortgage for a commercial loan. In Part II, we will look at how commercial loans are structured loans. First, let's look at the term of the note. The most common term for a residential loan is 30 years. In commercial lending, the loan repayment schedule, or "TERM", will be 20 to 25 years instead of 30 years that most residential borrowers are accustomed to. In the case of commercial loans, you will need to remember *that the shorter the term, the higher your monthly payment will be.*

Second, in most "usual" or "normal" lending situations, when a commercial loan is a "FIXED RATE NOTE," the normal term of the loan will be for 15, 20 or 25 years.

However, most commercial loans are written for shorter "TERMS". They will most commonly be written as 2, 3 or 5 year balloons or as Adjustable Rate Mortgages (ARMs). Commercial loans, in theory, are based on a 2.5 to 3% profit to the lender. This is 2.5 to 3% above what they are paying out to their depositors. In other words, your lender wants to lend to you on a shorter term basis to adjust for fluctuations in the market, most especially on those on the up side.

Third, always make sure you check for temporary prepayment penalties on any commercial loan. Lenders use prepayment penalties as a "protection" against early loan payoff. These penalties are meant to discourage "flippers" who should be using other outlets for borrowing.

Does putting a non recourse commercial loan on an IRA owned property make sense? This can be the million dollar question, and the answer is, yes and no.

The answer is YES, especially if it is the only way for you to buy this property. The answer is YES if your IRA doesn't have sufficient cash to purchase the property on its own. That was simple.

And the answer could be NO.

Do you remember our example for the "Debt Service Coverage Ratio" (DSCR)?

Let's review our example from Part I.

"A six flat is being sold for \$300,000 and has a net operating income of \$1908.00/ month. The lender uses a DSCR of 1.20 for a multi-family building. The net operating income (NOI) of \$1908/month is divided by 1.20 which leaves you with a figure of \$1590. This is the maxi-

um Principal and Interest - P&I - that can be applied and still meet expenses and "the cushion".

Using a 25 year amortization and interest rate of 7%, the maximum mortgage (PV) is \$224,950.00.

Again, the numbers, in the above scenario, are "doing all the talking". This property would require the IRA to use \$75,050 (25%) as a down payment.

In Part I, the \$300,000 six flat had net operating income of \$1908.00 per month and a monthly P&I payment of \$1590.

- Cost: \$300,000.00
- Net Operating Income: \$1908.00

Monthly Principle and Interest: \$1590.

This leaves you with a positive monthly cash flow of \$318.00 per month or \$3816.00 per year.

- Positive Monthly Cash Flow - \$318.00

Positive Yearly Cash Flow - \$3,816.00

Since the IRA put \$75,050.00 into the property with the down payment and receives cash flow of \$3816.00/year, the IRA is getting a 5.08% return on its money. Just divide $\$3816.00 / \$75,000 = 5.08\%$.

IRA return on investment (ROI) - $5.08\% (\$3816.00 / \$75,000.00 = 5.08\%)$

Why the mediocre-to-poor return? The interest rate or "cost to borrow money" was 7%. Paying more for money than the rate of return is rarely prudent investing.

- Interest Rate - 7%

IRA ROI - 5.08%

Yes, you can attempt to reduce expenses, but let's just look at this without manipulating the expenses. When does this make sense?

Here is when your answer will be YES:

Is your IRA purchasing the property for cash flow only or are you speculating on appreciation? If the 6 flat appreciates 6% a year and you sell in five years, the yield and return on the IRA investment jumps to almost 10.76%.

Six flat appreciation - 6% annually x 5 years = 10.76% (yield and return on money invested)

This part of the equation is explained for your benefit

only. You should know that your lender will never factor appreciation into the loan and will always assume a 0% rate of appreciation.

You now see how the power of leverage can provide you with additional investment opportunities. These are opportunities that you might not be able to take advantage of if you have to fund every purchase on an "all cash" basis.

Please make sure to consult your accountant or financial advisor for further analysis.

So, are you ready to become a lender? Maybe, but that is a discussion for another day. In the meantime, if you work the numbers and calculations in advance, you will be able to estimate the maximum mortgage the lender will extend to your IRA.

Who knows, some day you may even become interested in becoming "the wizard behind the curtain".

Steve Miskowicz is the President & Managing Member of Entrust Chicago, LLC. www.entrustchicago.com

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Self-Directed Options for 2006—Part 2 When Investment Markets Change

By: Hugh Bromma

During a time when the public is becoming wary of different investment markets, what does one do? The question is particularly interesting when you look at IRA and 401(k) funds. For one thing, whatever you have your tax-deferred money invested in, what is your goal? Long term appreciation? Accelerating income tax-free in a Roth because you are thinking of retiring at an early age? Opportunistic Investing? All these have their place for different people. As markets change in this and other countries, the opportunities change. Many people look at their real estate portfolio as cash flow vehicles, and hopefully cash producers on sale. Some individuals are looking for the inevitable opportunities of buying up foreclosures and "subject to" real estate. These opportunities happen when markets don't change, albeit more difficult to find. We have been hearing that buyers have had to bail out of contracts on single families and duplexes in certain expanding markets because the

job market in construction is shrinking. The purchase of a rental at a discount can be advantageous, but when will it bottom? Does your tax-deferred plan have the cash? How long will be your hold period? Do you need cash flow?

The point on what do when markets change, up or down, is to look at your personal strategies and needs when using your self-directed accounts. Above all, **do the numbers!**

Hubert Bromma is the CEO of The Entrust Group. For over 20 years, Entrust has been providing third party record keeping services for individuals who wish to acquire alternative investments. Entrust is the nation's largest administrator of self-directed retirement plans, with more than 27 locations nationwide. To learn more about Entrust, log onto our website at www.entrustusa.com.

IRA Investment in Denver Commercial Properties Gaining Momentum

By: Catherine Wynne

Historically, most retirement plans in the United States invest in securities of some sort, but gaining popularity over the last 4 years is the use of self-directed IRA administrators to facilitate real estate and lending deals. This concept is not widely known by either real estate or tax professionals, but continuing education classes are available to real estate brokers, CPAs, and other professionals. The result of this is a new source of funds for purchases and development.

Over the past 18 months, there has been a steady increase in the number of Denver commercial investors placing their IRA/SEP/401(k) retirement plans in real property via direct ownership, TIC arrangements, and LLCs. Investments have mainly been in improved property

such as retail and multi-family but there have also been deals involving construction lending. Many of these investments benefit from leverage from local lenders.

"Why don't I know about this?" is the reaction of most investors. The IRS has received this question so frequently that their website, www.IRS.gov, has posted their affirmation of the legality of the concept. **"IRA law does not prohibit investing in real estate but trustees are not required to offer real estate as an option. IRA trustees are permitted to impose additional restrictions on investments. For example, because of administrative burdens, many IRA trustees do not permit IRA owners to invest IRA funds**

in real estate”.

The investor or broker should know that first and foremost, they need a self-directed IRA Administrator to do this type of transaction. Secondly, the sales contract for these purchases needs to be initiated by the IRA at the client’s direction, and all funds must flow through the IRA administrator. Third, there can be no personal use of this property either by the IRA holder or close family members such as parents or children. Self-directed administrators are not allowed to be involved in the investment as either a promoter or an advisor but must remain completely neutral in the transaction. Fourth, leverage is permitted with some limitations.

Due diligence and decisions regarding improvements, property management and tenant selection may be performed by the IRA holder. Everything from the sales contract to the closing documents are signed by the Administrator who is responsible for the correct vesting of title and accounting to the IRS on the value of the account as well as any funds traveling into, and out of, the account.

Because it is within a tax-deferred account, the proceeds of the sale of property owned by an IRA/SEP/401(k) go directly back into the IRA trust account and are available for the next investment. Subsequent investments can be real estate, or anything else allowed by law, the only

statutorily prohibited investments being life insurance and collectibles. There is no need for a 1031 exchange or any “like kind” investment to replace it.

Contrary to popular belief, an annual appraisal is not required by the IRS on real estate within an IRA. Although it is true that the account value is reported annually to the IRS, there are no specific requirements for an appraisal. Appraisals are only required for a taxable event, such as when a property is taken out of the IRA. All rules about investing IRA funds revolve around the issue of self-dealing, which is defined as benefiting now from your IRA, and having transactions with your IRA. The code section dealing with “prohibited transactions,” as they are called, address these main areas of concern.

As securities become less the investment of choice, and real estate remains a solid investment, it is expected that retirement plan investment in real estate and notes will continue to grow over the next few years. Real estate brokers and developers can capitalize on this trend by marketing properties to retirement plans and seeking IRA investors in large projects.

Catherine Wynne is a real estate broker and Senior Vice President - Asset Acquisition, for Entrust New Direction IRA www.newdirectionira.com

MARCH MADNESS!!!

By: J.P. Dahdah

For basketball sports fans, the term March Madness refers to the excitement of the NCAA Tournament. Sixty-four college basketball teams battle it out on the hardwood for the pride and glory of being named National Champions. For investors, it relates to the stress and panic of organizing your financial affairs before the tax-filing deadline of April 15th. Some thoughts running through your mind may be: Have I saved enough this year to accomplish my family’s financial goals? What retirement plan best fits my family’s needs? Are we saving enough money for my child’s college education? Have my recent real estate investment deals created an additional tax liability for my family?

This process can be stressful and maddening. In an effort to help you put your financial house in order before April 15th, please find a few helpful tips below that should guide you down that right path.

Choosing the most appropriate type of retirement plan - To determine which type of plan is best for your family, you need to answer several simple questions:

- *How much can I afford to contribute towards my plan based on my current financial situation?* A monthly cash flow analysis (budget) can help you

determine this figure. If the amount you can afford is \$4,000 or less, a Traditional or Roth IRA would make the most sense. These accounts are easy and inexpensive to set up. Keep in mind that Roth IRAs have annual income limitations that make you ineligible for annual contributions if you make too much money, and they are also taxed differently than Traditional IRAs. Traditional IRAs allow you to make pre-tax contributions, while Roth IRAs are after-tax contributions. Make sure you consult with your tax advisor on which one would be most advantageous for your current tax situation.

- *Am I self-employed?* If you are self-employed, Uncle Sam allows you to choose from a longer list of retirement plans! These plans include SEP IRAs, Simple IRAs, Individual 401(k), Profit Sharing Plans, etc. The main advantage of these kinds of plans is that they have higher contribution limits. Therefore, if your annual budget allows you to save more than \$4,000 a year, you should consider establishing one of these plans. Be aware that if you have employees, these accounts also come with additional employer requirements which could burden you with additional financial responsibilities. Again, consult

with your tax advisor to determine what the additional financial impact may be and if it still makes sense.

So remember, first you determine *how much* money you need to save to accomplish your financial goals. Secondly, you analyze your monthly budget to figure out if you can afford it based on your income and expenses. Lastly, you choose the retirement plan that aligns your financial needs with your goals. It's as easy as 1, 2, 3!

J.P. Dahdah is president of Entrust Arizona. www.entrustarizona.com Serving the state of Arizona.

Leaving a Legacy of Saving

By: Glen Mather

As a father of four, I'm well aware of the cost of parenthood - from diapers to college and the uncomfortable teen years between. Yet the greatest obligation of all is to leave a legacy with your children that will long outlive you and your ability to provide for them.

Fact is, we hail from a country that is filled with non-savers, and it's not likely that any of our progeny will casually acquire the ability and aptitude to invest. Passing on the power of investment can be one of the most important lessons learned and will impact your child throughout their lifetime. Having that investment grow tax-free is even better.

Can a minor have an IRA? Absolutely - just two rules apply. First, the minor must have a Social Security Number (can be obtained shortly after birth) and have earned income. Well, how can a five-year old earn income? Perhaps you have your child (or grandchild) provide modeling services - and pay them for their work. Up to \$4,000 in earnings can then be contributed by the minor into a Traditional or Roth IRA. Just make sure that the employment that you are providing to the minor is legitimate. Paying the child for doing chores will likely not qualify.

Parents will serve as the trustee for the minor's IRA until he/she reaches the age of majority - 18. The choice of funding a Roth is especially powerful as the money will grow tax-deferred until the child reaches age 59.5 - then can be distributed tax-free. With a self-directed IRA, the parent can partner their child's investment with their own - or simply direct the child into the over 40 categories of investments that Entrust provides.

Assuming an 8% annual return (which is not unusual for

self-directed investors) and a contribution of \$4,000 per year until the child reaches 18, due to your forethought, the child may be able to retire early:

Total Contributions from year one to eighteen: (18 x \$4000) =	\$72,000
Gross Earnings year one to year 55 =	\$2,511,412
Total Retirement Nest-Egg at age 55 =	\$2,583,412

So, without further contributions from your child and assuming that they continue to self-direct their plan wisely, at age 55 they would have over \$2.5M in their account that would be taxed only upon withdrawal. Better yet, if the plan account was a Roth IRA, then the same funds would be available to your child tax-free at age 59.5.

Bottom line - while you are busy planning for your self-directed retirement plan, don't forget to invest in your child's future. It's easier than you think as they may be able to partner with your IRA and benefit from the due diligence and investment choices you make. It will be one of the best legacies that you provide to your children or grandchildren.

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www.entrustclientconference.com

Self-Directed IRA's - Not Just for Real Estate

By: Jaime Raskulinecz, CPM

After speaking with clients so often—one-on-one as well as in groups—I was confident that all the people I spoke with really understood all the possibilities available to them with The Entrust Group's self-directed plans. I was quickly brought up short recently when speaking with a few people. One was a client, John, and two were prospective clients, Curt and Sam, with their applications in hand. All three people were friends and familiar with some of the others' transactions and pending transactions. I, and others in my office, had been speaking with all of them over several months about our accounts and the possibilities for their investments.

The client, John, mentioned to one of his friends, Curt, that he was going to need a short term loan soon and he asked if Curt would be willing to lend him the money from his newly opened IRA account. The loan would be secured by a second mortgage on John's condo.

Curt and Sam were incredulous. They both said at once, "We thought these accounts were strictly for real estate investing!" You can imagine how surprised I was as we have had several conversations about this.

I realized that we have a tendency to concentrate on the real estate examples pretty heavily when explaining our business. This is primarily because this is the most popular investment choice when clients open an account with us. But, I think, it is also because it is simple to explain and the topic is sometimes overwhelming for the first

time client.

The IRS regulations say that the only investments not allowed in an IRA are life insurance and collectibles. And, IRAs may not invest in S-Corporations although other entities are allowed.

Some of the inquiries for non-traditional investments we've gotten in the past few months include off shore hedge funds, domestic hedge funds, investment capital for a start up truffle farm in the south, investments in credit card debt, investments in oil and gas TIC instruments, a bed and breakfast in Central America, shares in a Costa Rican Corporation formed to invest in real estate in Costa Rica, hard money loans, first and second mortgages, and unsecured personal loans.

These are just some of the many choices available to you. So please think about more than just real estate when you think about investing with your retirement funds. The choices are only limited to the depth of your imagination. And the IRS regulations, of course!

Jaime Raskulinecz, CPM is the CEO of Entrust Northeast, LLC, www.entrustnortheast.com Serving New York, Northern New Jersey and Connecticut.

IRA Opportunities Abound with Tenants in Common Real Estate Investing

By: Dave Owens and Patrick Hagen

As real estate prices have continued to escalate, it can be more difficult for a young investor to purchase a piece of property outright. Many of our clients get their IRA involved in larger real estate investments along with other investors through tenants in common arrangements. Below is an example of how a young client, with limited IRA funds, involved his IRA in a larger real estate purchase.

Craig Albert is a 25 year old young professional. He worked his first two years out of college with a small community bank that offered him participation in a company sponsored 401(k) plan. When he left his job with the bank, he rolled the vested 401(k) funds to a Traditional IRA with Gainesville Financial Services. He then added \$4,000 to the account for his 2005 IRA contribution.

Craig was interested in investing in real estate through his IRA. At that time, he only had \$12,000 in his account, and he realized that he could not purchase a piece of property outright with such a small balance. He did some research and found that his IRA can partner with other parties to make a purchase. Craig's IRA: Tax Free Strategies LLC FBO Craig Albert #62501, can partner with other investors through a tenants in common arrangement.

Several of Craig's friends decided to go in on an investment of a piece of raw land in Punta Gorda, Florida. There are five investors all together; two IRAs and three individual investors. All five are cash partners on the purchase.

Craig submitted the appropriate paperwork to Tax Free Strategies instructing them to initiate the purchase of 10% of the property with his IRA. On the day of closing, Tax Free Strategies wired funds from Craig's IRA to the title

company to close on his 10% of the property. All documents clearly specify each party involved and their respective percentage of ownership. The 10% interest held by Craig's IRA was reflected on the recorded Warranty Deed. Craig's IRA is responsible for 10% of all expenses to the property.

Two years later, property values have nearly doubled. When the property sells, 10% of the sale proceeds will go back to Craig's IRA. There will not be capital gains tax on the appreciation because the 10% ownership is held in the IRA. The returned funds will remain in the IRA money market account until Craig instructs Tax Free Strategies to make another investment.

Dave Owens is the owner of 1031 Tax Free Strategies in Fort Myers, Florida. Patrick Hagen is the area manager for Entrust Gulf Coast, located in Gainesville, Florida. www.taxfreestrategies.com www.entrustgulfcoast.com

TIP OF THE MONTH

Know investment basics before you invest. What do you invest in with your IRA or 401(k)? Real Estate, Loans, Equities, CDs, Private Placements? Most investors go into an investment blind. Learn the facts about the type of investment and the risks to it, before you invest.

INTERESTING INSIGHTS

Are you keeping up with technology? The content from Web logs, or blogs, has grown astronomically in the past few years. A blog is a website arranged much like a diary. Older postings are usually archived automatically for future reference, and most blogs have an option for readers to post comments. An estimated 21 million Web blogs currently exist worldwide, and another 70,000 blogs are being created each day. Blogs are the fastest growing medium on the Internet.

Source: Alaska Airlines Magazine

Seven Million Americans Working After Retirement.

A study by Putnam Investments says that about seven million previously retired U.S. citizens have returned to work after an average retirement period of one-and-a-half years. The "working retired," as the study puts it, now represent about 10% of the U.S. workforce composed of those at age 40 or more, according to the study.

Source: Financial Advisor Magazine

Economists gathered in Chicago to answer the question, "Is there a housing bubble?" They predicted that housing prices will level out, rather than crash.

Source: Mortgage News Services

QUESTION OF THE MONTH

"Realtor Fix and Flips"

I am a Realtor and do 1 or 2 fix and flips per year. I just had my offer on a HUD property accepted. The contract will be ratified by HUD within the next day or two and I will need to close within 45 days of ratification. I want to use my IRA to purchase the property and pay for improvements, most of which would be done by independent contractors. Some minor things, like purchasing appliances, sinks and faucets, would be done by me. I would not charge for my labor. I would then list and sell the property through my Keller Williams Office.

I would not receive any commission on the transaction.

Question:

- 1.) Can I do this?
- 2.) How would I get reimbursed for improvements like appliances, faucets etc.?
- 3.) Would I be considered a dealer?

Answer:

1. Your IRA could have made the offer to purchase the property, but as you already have it under contract personally you can not subsequently give the contract to your IRA.
2. You are not allowed to contribute your own labor to the IRA's asset. Contributions to your IRA must be made in cash paid to the administrator.
3. The IRA may be considered a dealer, just like any one who buys and sells real estate as an inventory item. The rules as to when one is and when one is not a dealer are subject to the individual facts and circumstances of the transactions. Generally, intent to buy the property for resale and profit, rather than intent to hold as a rental, is indicative of being a dealer.

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