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ASSETS

## Using an I.R.A. to Buy Real Estate

By [VIVIAN MARINO](#)

**F**OR years, Jack Povia kept all his retirement money in the stock market and watched as his investments grew, on average, 12 to 15 percent annually, a return many other investors would envy.

But Mr. Povia, a 47-year-old financial planner from Toms River, N.J., wasn't content. He attained these yields in his Individual Retirement Account, he said, "only because I was more of a risk taker; I was putting all my money in growth stocks."

He is still taking risks, except now he says he has more to show for them. Two years ago he shifted that money, "in the six-figure range," into a so-called real estate I.R.A. He used the funds to buy, then later sell, a five-acre parcel near the Jersey Shore.

"I have pretty much doubled my money since I started," Mr. Povia said.

Although most of the 45 million households with I.R.A.'s stick with stocks and bonds, an increasing number are switching to real estate, hoping for more lucrative returns. Industry experts estimate that 2 percent of I.R.A. money is invested in real estate - through "self-directed accounts" held by a custodian and managed by the account holder - twice as many as two years ago.

"Interest has really blossomed in the last 15 months," said Tom W. Anderson, chief executive of Pensco, a firm in San Francisco that specializes in the administration of I.R.A.'s for nontraditional investments.

At Pensco, about \$484 million, or roughly 40 percent of the \$1.2 billion in assets under management, is in real estate, about \$200 million more than in 2003, according to Mr. Anderson, whose numbers are echoed by competitors. In past years, he said, real estate typically made up 25 to 30 percent. "We're going to see even more growth as people look for more tangible assets," he said, "and as more people become aware of this investment option."

Investors have always been allowed to hold real estate in I.R.A.'s. Yet few people seemed to know they could, and financial institutions had little profit incentive to recommend something other than stocks or mutual funds. Investors have been rethinking their strategies as the increase in home values surpasses returns on Wall Street.

While there is a potential for higher returns, real estate I.R.A.'s aren't for everyone. Conducting transactions through a tax-sheltered account subject to many regulations can be complicated, and rule breakers face severe penalties. "If you have a choice between owning real estate inside or outside of an I.R.A., I definitely recommend owning outside," said Bernard S. Kent, a partner at PricewaterhouseCoopers.

One disadvantage is that investors can't take the usual deductions for real estate. They also can't use real estate owned by an I.R.A. as a primary residence, vacation home or business base. Family members, too, could not have owned the property. Once a property is chosen, the I.R.A. custodian - not the account holder - must buy it. Fees vary widely among custodians.

Cash flow can be an issue as well. All property expenses, from taxes to repairs, must be paid from funds in the I.R.A., which means investors will need to have plenty of liquid funds available. (The average I.R.A. holds just \$25,000 in assets.)

"The accounts that want to directly invest in a piece of real estate are well into six figures," said Kelli L. Click, a vice president at the Sterling Trust Company, a self-directed I.R.A. custodian based in Waco, Tex.

Of course, one way to make an I.R.A. grow is through annual contributions. (The deadline for the 2004 tax year was last Friday; the maximum contribution is \$3,000, or \$3,500 for those 50 or over.) Another way is to roll money from a 401(k) plan into the account. Separate accounts can also be pooled to form partnerships to raise buying power.

Investors like Mr. Povia of Toms River say the advantages of owning real estate in an I.R.A. still outweigh any disadvantages. For one thing, the capital-gains tax on an I.R.A.-sold property can be deferred - or eliminated in some cases. Any rental income or profits go directly into the account, where it can grow further.

I.R.A. holders also have few limitations on what they can buy - single-family houses, apartment and office buildings, shopping centers, hotels, tax-lien certificates and raw land all qualify.

Edward A. Slott, an accountant in Rockville Centre, N.Y., who publishes a newsletter about I.R.A.'s, says that Roth I.R.A.'s work best for handling real estate transactions. Investors won't owe taxes at distribution, when the investments have appreciated over time, he noted. In a traditional I.R.A., once money is withdrawn, funds are taxed as regular income.

Still, Mr. Slott thinks the average I.R.A. investor might be better off with real estate investment trusts, or REIT's, publicly traded companies with portfolios of real estate that pay out most of their income in dividends. "You have an exposure to real estate," he said, "but you don't have to worry about leaky roofs."

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