

June 29, 2005

Wary of Stocks? Property Is an I.R.A. Option

By [VIVIAN MARINO](#)

Like many other investors, Ray Matteson, an executive at a data-processing company, was caught in the dot-com maelstrom of the late 1990's, except that his losses were on a far grander scale than most - about \$3 million by his calculations and all of it in a retirement account.

But Mr. Matteson, 60, who had amassed a fortune through an employee stock ownership plan, says he has managed to recoup most of those losses. About two years ago, he shifted his money from a traditional individual retirement account into a so-called real estate I.R.A., and he used money in the account to buy a 105,000-square-foot warehouse in his hometown, Sacramento.

"I paid \$4.3 million for it last year, and if I sold the building today, I could probably get around \$5 million to \$6 million," said Mr. Matteson, adding that he also receives a steady stream of income from his 12 commercial tenants, producing a 9 percent annual return.

While a vast majority of the 45 million households with I.R.A.'s are still in stocks and bonds, more investors are focusing on real estate, hoping to cash in on the robust market. An estimated 2 percent of I.R.A. money is now invested in real estate in one form or another - through self-directed accounts held by a custodian and managed by the accountholder - twice the percentage of two years ago, according to industry experts.

Real estate has always been permitted in I.R.A.'s, but few people seemed to know about this option - or even care - until the stock market began to decline. Financial institutions, meanwhile, had little incentive to recommend something other than stocks, bonds or mutual funds.

There are few restrictions on what investors can hold in these self-directed accounts. Qualifying properties include apartment and office buildings, shopping centers and warehouses as well as single-family houses. Investors cannot use commercial space owned through their I.R.A.'s for their own businesses.

Most real estate I.R.A.'s now are in residential property, according to account administrators, but they say they are seeing more and more commercial deals. Typically, these involve high-net-worth clients with substantial assets in their retirement accounts.

"People are looking for ways to accelerate their asset values, and they're not getting those returns in the stock market," said Hubert Bromma, chief executive of Entrust Administration, a company in Oakland, Calif., that specializes in the administration of I.R.A.'s for nontraditional investments. The company has \$1.5 billion in assets under management; two-thirds is in real estate.

Tom W. Anderson, president and chief executive of the Pensco Trust Company, a self-directed I.R.A. custodian with offices in San Francisco, said that he was also seeing more interest in real estate investments. As of this year, about \$604 million of the \$1.25 billion in assets Pensco manages was in property or real estate investment trusts, known as REIT's, which are publicly traded or private companies with portfolios of commercial property. Last year, the total was \$480 million, and in 1997, \$100 million. The company did not provide a breakdown between commercial and residential real estate.

Because commercial property is typically more expensive than residential, many account holders are choosing to become part of private investment syndicates, Mr. Anderson said. "They may pool their money to buy retail strip malls or other buildings," he said.

Indeed, the biggest obstacle to investing in commercial real estate is expense - for the property as well as the custodial fees, which can vary widely. Investors can take out loans, though financing inside an I.R.A. can be complex. All property expenses, from taxes to repairs to loan payments, must be paid from funds in the I.R.A., which means investors will need to have plenty of liquid funds in the account. Mr. Matteson, for instance, pays \$1,200 a month for the property manager that looks after the building, which generates about \$40,000 in monthly revenue, all of which flows into his I.R.A.

"You would have to have a prodigious I.R.A. to be able to sink money into a commercial real estate property," said Jonathan Pond, a financial adviser from the Boston area.

Small investors can gain a presence in commercial real estate through REIT's or partnerships, but administrators say that most self-directed I.R.A.'s should have at least six figures to invest. That is not so uncommon, Mr. Bromma

said, considering that "there are a lot of people rolling over money from 401 (k)'s, professionals in high-level positions."

Mr. Matteson certainly fits into that category. His retirement account originated from a 401(k) plan awash with stock from his employer, [DST Systems](#) of Kansas City, Mo.; then the money was rolled into an I.R.A. after a merger, he said.

After his Internet losses, Mr. Matteson pulled out of Wall Street entirely. "I got tired of going to bed at night wondering how much I was going to lose the next morning," he said.

Mr. Matteson says he hopes to buy a second warehouse sometime this summer - this one is 125,000 square feet and near the first building - through his I.R.A., which is managed by Pensco. This time he will have to take out what is known as a nonrecourse loan, which means that the lender's ability to collect the money borrowed is limited to the collateral within the account and not the personal assets of the borrower.

"These two buildings, three years from now, will throw off \$100,000 a month in after-expense, before-tax income," he said. "I can have the debt paid off in three to five years."

While there is growth potential in commercial real estate investing, there are also disadvantages to making property purchases within an I.R.A. For one thing, investors can't take the usual deductions for real estate, and they could face stiff penalties if they fail to comply with various I.R.A. rules including those on contributions and withdrawals.

Real estate transactions work best in Roth I.R.A.'s, financial advisers say. In a Roth account, investors will not owe taxes at distribution, when the investments have appreciated over time. When money is withdrawn from a traditional account, funds are taxed as regular income.