A Savvy Investor's Success Story

How the flexibility of a self-directed IRA helped a real estate investor increase returns

The Entrust Group

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David Castle*

Age: 64
Occupation: Realtor
Location: Roseville, California
Marital Status: Married
Children: 2 boys, ages 25 and 31
Hobbies: Jogging, golf and family time

*Client's name has been changed to protect identity

Investing in what you know is a tried-and-true strategy among self-directed IRA investors. David Castle is a good example of how well that can succeed.

In early 2006, David Castle, a savvy real estate broker from California, wanted to diversify his retirement investments beyond the usual stocks and bonds. His existing Roth IRAs were held at Morgan Stanley, Fidelity Investments, and Wachovia Securities (today known as Wells Fargo Advisors). David wanted to take more control of his investment choices to gain potentially higher returns on alternative investments. With more than 30 years of experience in both California and Texas real estate markets, he realized he wanted to invest in what he understands… REAL ESTATE!

Convinced that his investments could earn more, David opened an account with Entrust and transferred $120,000 into an Entrust Roth IRA. To maximize the amount of dollars he could invest in real estate, he considered making an annual contribution. David evaluated his previous year's income and realized he could make a contribution before the tax filing deadline in April. When an investor like David selects a Roth IRA to invest in real estate, the gains on real estate are tax-deferred and may also be distributed tax-free in the future, if certain requirements are met.

Roth vs. Traditional

The fundamental difference between a Traditional IRA and a Roth IRA is how they are taxed upon distribution. Traditional IRA contributions are made out of pre-tax income, and the funds contained in these accounts are allowed to grow tax-deferred. Distributions are typically taxable. Alternatively, Roth IRA contributions are made out of post-tax income. Funds invested in a Roth IRA account grow tax-deferred and will be tax-free if certain requirements are met.

David completed his transfer to Entrust in just a few simple steps:

How the Transfer Process Works

1. David opened a self-directed Roth IRA with The Entrust Group
2. He requested recent statements from his old Roth IRA providers
3. David completed the Entrust Transfer Form
4. He sent the completed form to Entrust with a copy of his Roth IRA account statements
5. The professionals at Entrust handled the paperwork from that point on

Soon after, Entrust received the funds for the total amount of $120,000 from the Roth IRAs at the other financial institutions, and the funds were deposited into David's new Roth IRA at Entrust. The transfer process was complete, and David started to consider various funding options to purchase real estate investments through his Roth IRA.

What's the difference between a transfer and a rollover?

A transfer is the term used when the same type of retirement plan is moved from one firm to another. In a rollover, you request a distribution of your retirement plan assets and deposit it back within a 60-day period.

All forms and documents needed for this process can be found here: theentrustgroup.com/forms

A Breakdown of Funding Options:

Direct Purchase

A direct investment involves purchasing a physical property and collecting the income generated within your self-directed retirement account.

Partnering

You can partner your IRA with personal funds or other IRA funds. You can also partner with other people's IRAs or their personal funds.

Leveraging

Your IRA borrows money to purchase a property with a non-recourse loan and the leveraged property is held in

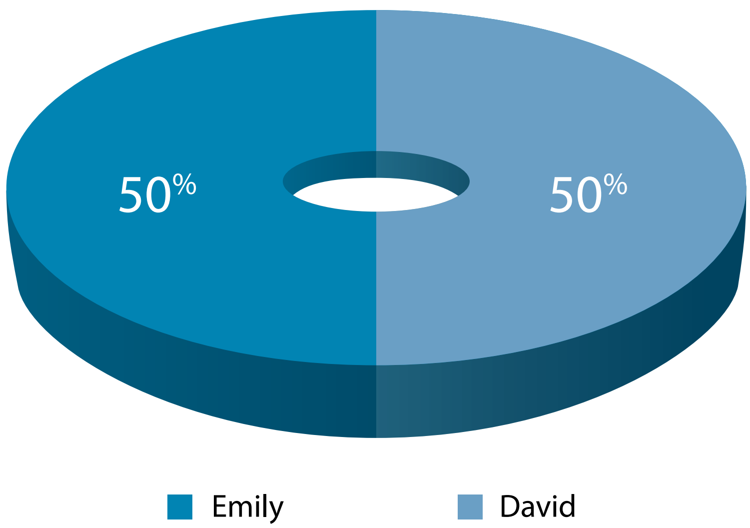
LLC

A limited liability company, or LLC, is an entity often formed and used to purchase real estate in an individual's IRA using IRA assets as a funding source. The IRA holds

Why Partnering Worked for David

David chose to partner his IRA because it gave him more money to work with. His wife Emily already held an IRA account with Entrust, which made the process easier. They divided the investment equally, 50-50. This option also split the profits and expenses for the investment equally. This gave the couple more money to work with on the offer, and both investors reap the benefit of a more diverse portfolio. Emily's IRA will fund 50%, and David's IRA will fund the other 50%:

A self-directed IRA can partner with anyone at the time of initial purchase, but after the transaction is complete, the IRA cannot conduct any business with a disqualified person. Doing this could lead to significant tax penalties.



Selecting a Property and the Pre-Purchase Process

David and Emily were ready to invest! The couple decided they would start looking at properties in Texas. David, being a licensed Texas real estate agent himself, was fully capable of doing the transaction on his own. However, according to IRS rules and regulations, any transaction conducted by an individual for the gain of commission on the investment would be prohibited. To avoid engaging in a prohibited transaction, David sought out and found a Texas real estate agent who understood how self-directed IRAs work to facilitate the transaction.

With reasonable effort, David and his real estate agent found a promising single-family residence in the suburbs of Austin. The property was listed at $35,000 at the time (2006), and needed work with basic renovations to the bathrooms and kitchen.

Due Diligence and Why It Matters

Immediately after selecting the investment property, David completed some important inspections and proper due diligence by researching the property claims history. Proper due diligence is the first checkpoint in determining whether or not to proceed with an investment in real estate from a small rental property to a large commercial building. Although all the research in the world cannot guarantee a real estate investment will produce a positive return, diligent research can help protect against fraud.

David went as far as reading all documents associated with the property, such as leases, Homeowner's Association documents (if applicable), and previous insurance policies. Fortunately, he didn't come across any red flags, and he continued his investment process.

Examples of prohibited transactions in a real estate IRA may include direct and indirect transactions:

- Buying the property of a disqualified person with your IRA
- Borrowing money from your IRA to pay off a personal mortgage
- Living in the property owned by your IRA

Working with a real estate agent and a title company that understand self-directed IRAs is key. Make sure they understand that the title for the investment is held in the name of the IRA: "The Entrust Group, Inc. FBO [Client Name] Account # [Entrust Acct. Number]"

When buying residential real estate, consider all variables involved in managing your new investment like property managers, maintenance, property tax, insurance, and any additional expenses that may arise. All expenses of the property must be paid using IRA assets.

Purchasing the Property Through an IRA

Feeling confident about their investment decision, David and Emily partnered up, and completed the paperwork at Entrust to purchase the property through their IRAs:

1. David and Emily completed an Entrust "Buy Direction Letter Form"
2. They made an offer of $35,000 in the name of their established IRA accounts:
   - The Entrust Group Inc., FBO David Castle Account #12345, 50% undivided interest and The Entrust Group Inc., FBO Emily Castle Account #67899, 50% undivided interest
3. A good faith deposit of $1,000 was processed from the Entrust IRAs
4. The title company prepared the documents (David and Emily read and approve the documents. However, the closing documents are signed by Entrust on behalf of the IRA.)
5. Entrust sent the signed and completed documents back to the title and escrow company
6. Entrust wired the proportionate amount of $17,500 from David's IRA to fund 50% of the purchase of the property, and the proportionate amount of $17,500 from Emily's IRA to fund the other 50% of the purchase of the property to the title company
7. The purchase was completed, and David and Emily IRAs owned the investment property
8. The deed was recorded in the name of the IRA:
   - "The Entrust Group Inc., FBO David Castle Account #12345, 50% undivided interest and The Entrust Group Inc., FBO Emily Castle Account #67899, 50% undivided interest"

David and Emily are satisfied with the investment!

How Operating Income and Expenses Work

David and his wife had options of what to do with the property once they bought it: flip it or rent it out. Either way, they first had to renovate the kitchen and bathrooms. They knew they could not use their personal funds for any renovation expenses. All maintenance and renovation expenses for a real estate IRA investment must be paid from the IRA. Additionally, any revenue from the investment property, like rental income, will go back into the IRA.

David and Emily decided to rent the newly remodeled property to get some of their renovations cost back. Before looking for potential tenants, they strategically hired a property manager to handle and oversee the property. Hiring a property manager was essential in their situation to avoid the possibility of engaging in a prohibited transaction. As a safety net, it is advisable to have someone other than the IRA owners handling the day-to-day operations for the property.

After the property manager was hired, the property was posted online through classified listings, and tenants moved in within 30 days. Every month, a rental payment of $990 from the new tenants was deposited into David and Emily's Entrust IRA account monthly, with $495 going into each IRA. After a few years of rental income, David and Emily had recouped the cost of the renovations. Because the rent paid to an IRA is not taxed, they were able to earn back their renovation expenses much quicker.

It is important to keep cash in your IRA for upgrades or property maintenance.

Example: When a new sink is needed, the IRA must have enough funds to replace or fix it. Other expenses, such as property insurance, real estate taxes, and assessments must be paid out of the IRA as well.

Selling the Rental Property

Fast-forward nine years to 2015. David and Emily had the property appraised and were thrilled to learn how much the value had increased. They decided the time was right to sell. Working with a realtor who found comparable properties that had sold for a higher value; they put the property on the market. After receiving numerous bids, David and Emily found a local buyer who was very happy with the property. The additional renovations paid off and the property was sold at a profit.

For Entrust to sell the property to the new buyer, David and Emily had to fill out a Sell Direction Letter Form, and submit it to Entrust. Once the paperwork was processed through Entrust and the title company, the sale of the property was closed, and the title of the property was transferred over to the name of the new buyer.

The Numbers For Return On Investment

- The investment property bought in 2006 for $35,000 sold for $153,780 in February 2015
- David and his wife made an investment profit for the total of $118,780*
- Each IRA received $59,390 from the sale of the property
- Each investor had a 14.4%** return per year

David executed this savvy strategy to invest in real estate with his self-directed IRA by earning rental income from his investment, renovating it with rental funds, and selling the property at a profit. This type of strategy is now a regular element of his retirement saving strategy.

*Rental income and expenses during the nine years are not calculated in this total

**Annual rate is compounded

The Benefits: Increased Returns With Investments You Know

To summarize, investing in real estate with an IRA to build retirement savings with a higher return on investments was a successful strategy. A self-directed IRA gives investors like David the opportunity to invest in what they know, diversify their portfolio, and enjoy the benefits of protection against inflation in a tax-deferred account. In David's case, investing in a single-family property offered two very valuable things:

- A steady revenue stream of income from the property on a tax-deferred basis
- The equity built up by selling at the right time

David is now 64 and close to retirement; this means that he does not currently have to pay taxes on distributions when he starts taking them from his Roth IRA. Generally, you need to reach 59 ½ years of age and have opened a Roth IRA for 5 years before taking distributions in order to avoid paying taxes.

David, being a savvy investor realized many benefits from the transaction, but the most important benefit had to be the freedom to build toward a more comfortable retirement.

There are additional exceptions that qualify for tax-free distributions for your Roth IRA after you have opened a Roth 5 years ago:

- If you become disabled
- Withdraw funds for a qualified first home purchase (this has a maximum of $10,000)
- Die and have your account balance paid to your beneficiary without reaching the aforementioned age

The tax-free distributions from your Roth IRA is called by Congress as a Qualified Distribution. Note that the 5 years and one of the 4 mentioned above must both be satisfied to qualify for this.

About The Entrust Group

For almost 40 years, The Entrust Group has provided account administration services for self-directed, tax-advantaged savings plans, and has been an acknowledged authority in the field. Entrust facilitates the investment of alternative assets that are typically unavailable through a brokerage firm in self-directed retirement plans. Entrust's team of professionals are regularly examined to ensure compliance with current state and federal banking requirements, and keep up to date by participating in ongoing educational programs to ensure that the most accurate information is shared with clients.

To learn more, visit www.theentrustgroup.com

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