Building Value / *By Ray A. Smith*

Investors Find Ways to Put Pension Money Into Real Estate

INVESTORS ARE discovering ways to buy bigger and more expensive properties with their individual 401(k) retirement plans.

Last year, tax laws allowing individuals to set up single-participant 401(k) plans went into effect, and a number of firms began to offer services allowing these plans to invest in real estate, an activity single-participant IRA plans had long been doing. The laws also increased the limits on contributions to 401(k) plans and individual retirement accounts. But because the maximum investors can put into 401(k) plans is $40,000 a year, and $3,000 for IRAs, combined with tight restrictions on obtaining mortgages, many properties are beyond the financial reach of solo pension plans.

Now, accountants, tax attorneys and investors have come up with some creative ways to expand the range of properties the plans can buy—to include, for example, a high-end mall or even a Class A office building in a major city. Investors need to know what they're getting into, though, because these alternative methods can be quite complex, and, ultimately, hard to unwind. So consulting a tax attorney is highly recommended, especially since this area of investing involves the federal tax code.

Pooling Resources

One strategy, suggested in the recent book "Real Estate Loopholes: Secrets of Successful Real Estate Investing," is pooling pension plans to buy properties. Two or more investors with so-called self-directed plans could, for example, form a limited partnership or a limited liability company to purchase the property.

Diane Kennedy, a certified public accountant in Phoenix and co-author of the book, says investors in single-participant pension plans can also buy shares or interests in limited partnerships that acquire commercial real estate. A limited partnership is made up of limited partners and a general partner. Interests, or shares, in real estate are sold through brokers or financial dealers. Another option: forming a partnership with a private investor who will manage the property.

In each case, a third-party custodian—such as Equity Trust Co. in Elyria, Ohio, or Sterling Trust Co., of Waco, Texas—would handle all the transactions, including reviewing and signing any documents, forwarding funds to the seller and reporting to the Internal Revenue Service. The custodian also holds the interests in the limited partnership on the behalf of investors. Ms. Kennedy suggests that people who don't know others who want to pool should talk to their accountants and attorneys to see if they have clients who are interested in pooling plans.

"The beauty of this is that the profits [generated from rent] go into your pension account," says Garrett Sutton, an attorney in Reno, Nev., and Ms. Kennedy's co-author. "And later when it's sold, the profit goes into the pension account. You're really leveraging your money that way."

Things to Consider

There are some caveats to consider. Management fees for the party running the property can add up. What's more, investors have to divvy up the income generated from rent.

"You get just a proportionate share of the profits" because the investor is sharing ownership with other parties, says Richard Desich Jr., vice president of Equity Trust.

Moreover, it isn't easy to get out of a partnership or to sell an interest. "Those are usually fairly illiquid investments," meaning they are hard to convert into cash, says Gary C. Pokrant, tax principal with Reznick Fedder & Silverman P.C. in Bethesda, Md. Partnership structures are also complicated by the fact that the partners or owners typically all have to agree on important decisions related to the property.

A solo-plan participant choosing to invest in real estate faces risks typical of most landlords: the loss of a tenant or tenants and tenant defaults. The crucial difference is that for individuals, the loss of income from such events will hurt their retirement money. A bad bet could wipe out retirement savings.

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Self Interests

Self-directed pension plans can invest in single-family and multi-unit homes, apartment buildings, co-ops, condominiums, shopping centers, office buildings, warehouses and land. But there are certain restrictions:

- You may not personally own property that you intend to purchase with plan funds.
- You must ensure that your intended purchase isn't a transaction prohibited by the IRS.
- The property must be purchased for investment purposes only.
- Neither you, your spouse, nor family members (except for siblings) may have owned the property prior to its purchase.
- Neither you nor your family members (other than siblings) may live in or lease the property while it's in the plan.
- Your business may not lease or be located in or on any part of the property while it's in your plan.

Sources: Diane Kennedy, Garrett Sutton, co-authors of "Real Estate Loopholes: Secrets of Successful Real Estate Investing"

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