TAX & WEALTH STRATEGY

Investing Through Retirement Accounts

How retirement funds may be used for private multifamily investments.

Many investors are familiar with holding stocks, mutual funds, and bonds inside an IRA or employer retirement plan.

Less familiar is the idea that certain retirement accounts may also be able to invest in **private real estate offerings**, including interests in multifamily investments.

Doing so requires a different structure. In many cases, the investor needs a retirement account or plan that permits alternative assets, such as a **self-directed IRA.** Some other retirement plans may also permit participant-directed alternative investments depending on the plan documents, administrator, and applicable rules.

THE IMPORTANT IDEA

Your retirement account makes the investment. You do not make the investment personally. That distinction affects everything from how the subscription documents are completed to where distributions are sent and what you can - and cannot - do with the investment.

01 WHAT IS A SELF-DIRECTED IRA?

It Is an IRA With Broader Investment Choices

"Self-directed IRA" is commonly used to describe an IRA held by a custodian that permits a wider range of investments than a typical brokerage IRA.

EXAMPLES MAY INCLUDE

- Private real estate
- Private companies
- LLC interests
- Limited partnership interests
- Certain debt investments
- Other alternative assets permitted under applicable rules.

WHAT TO REMEMBER

- Real estate may be permitted under federal IRA rules.
- Individual custodians can impose additional restrictions.
- Not every brokerage or trustee offers alternative assets because administration is more complex.

TRADITIONAL IRA VS. ROTH IRA

Both Traditional and Roth IRAs may potentially be self-directed if the custodian permits the investment. The basic tax treatment differs:

TRADITIONAL IRA

- Generally provides tax-deferred growth.
- Taxable distributions are subject to applicable rules.

ROTH IRA

- Uses after-tax contributions.
- Qualified distributions may generally be tax-free when applicable requirements are satisfied.

Whether either type is appropriate for a private real estate investment depends on the investor's circumstances and should be discussed with a qualified tax or retirement-plan adviser.

02 THE ACCOUNT IS THE INVESTOR

Keep the Ownership Structure Clear

Suppose you want to invest **$100,000 of IRA** money in a multifamily partnership. You generally would not personally subscribe to the investment and then reimburse yourself from the IRA.

YOUR RETIREMENT ACCOUNT
owns the investment interest

↓

Contributes capital to

THE MULTIFAMILY INVESTMENT ENTITY

↓

Owns directly or indirectly

THE APARTMENT PROPERTY

ACCORDINGLY:

- Subscription documents generally identify the retirement account as the investor.
- Capital should come from the retirement account.
- Investment distributions should return to the retirement account.
- Sale or refinance proceeds attributable to that interest should return to the account.
- Personal and retirement-account funds should not be mixed.

THE IMPORTANT IDEA

If the retirement account owns the investment, the economic activity associated with that investment generally needs to remain inside the retirement-account structure.

Money should not move back and forth between you personally and the investment simply because you are the beneficial owner of the retirement account.

03 THE ROLE OF THE CUSTODIAN

Administration Is Not Investment Approval

An IRA must be held by an appropriate trustee or custodian. For an account holding private investments, the custodian may establish and administer the account, hold records, process investment instructions, transfer funds, receive distributions, perform required tax reporting, request valuation information, and charge administrative or asset-related fees.

A CRITICAL DISTINCTION

A self-directed IRA custodian generally does not evaluate whether the investment is good, safe, legitimate, or appropriate for you.

A custodian agreeing to process a transaction should not be interpreted as due diligence or an endorsement of the sponsor or investment.

Robert's Perspective

This is an area where I think investors can develop a false sense of security. The presence of a recognized custodian can make a transaction feel vetted. **It is not.**

The custodian administers the retirement account. You remain responsible for evaluating the investment.

04 HOW THE PROCESS GENERALLY WORKS

From Retirement Account to Investment

The specific process varies by custodian and retirement plan, but the basic sequence may look like this.

1 ESTABLISH AN ELIGIBLE ACCOUNT

Use a retirement account capable of holding the private investment. For an IRA, this commonly means a custodian that permits alternative assets.

2 FUND THE ACCOUNT

Funds may already be in the account or may arrive through an eligible contribution, transfer, or rollover. Different rules apply to each method.

3 REVIEW THE INVESTMENT

Evaluate the sponsor, property, market, business plan, financing, fees, liquidity, and risks just as carefully as if you were investing non-retirement funds.

4 COMPLETE INVESTMENT DOCUMENTS

The retirement account is generally identified as the subscribing investor. Exact titling should be coordinated with the custodian and sponsor.

5 THE CUSTODIAN SENDS THE FUNDS

At the investor's direction and after administrative requirements are satisfied, the custodian sends capital from the retirement account.

6 PROCEEDS RETURN TO THE ACCOUNT

Distributions, refinance proceeds, and sale proceeds attributable to the retirement account's investment generally return to that account - not to the investor personally.

05 PROHIBITED TRANSACTIONS

This Is One of the Most Important Areas to Understand

Retirement accounts receive significant tax advantages. In exchange, the law restricts certain transactions involving the account owner and other **disqualified persons.**

- Borrowing money from the IRA.
- Selling property to the IRA or exchanging property with it in a prohibited arrangement.
- Using the IRA as security for a loan.
- Purchasing property for personal use with IRA funds.
- Improperly using retirement assets for the personal benefit of a disqualified person.
- Certain self-dealing, lending, or furnishing of goods, services, or facilities.

Who May Be A Disqualified Person?

Depending on the rule involved, this can include the account owner, certain fiduciaries, and specified family members and related parties. The definition is technical. Do not assume that a transaction is permitted simply because it appears economically fair.

THE CONSEQUENCES CAN BE SERIOUS

Do not personally use, borrow from, benefit from, or transact with an IRA-owned investment without first understanding whether the transaction is permitted.

For an IRA owner who engages in a prohibited transaction involving the IRA, the account can lose its IRA treatment under applicable rules, potentially creating a taxable distribution.

06 DEBT CAN CREATE AN ADDITIONAL TAX ISSUE

A Retirement Account Does Not Automatically Make Every Dollar Tax-Free

This surprises many investors. Retirement accounts are tax-advantaged, but certain types of income can still create tax obligations inside the account.

One issue that can arise is **Unrelated Business Taxable Income (UBTI).** For real estate investors, an important component can be income associated with **debt-financed property**, often discussed as Unrelated Debt-Financed Income, or UDFI.

Why does that matter? Multifamily investments commonly use mortgage debt. If a retirement account invests in an entity that owns leveraged real estate, a portion of the income or gain allocated to the retirement account may be subject to these rules, depending on the structure and circumstances.

THIS DOES NOT MEAN

"You cannot use retirement money to invest in leveraged real estate."

It means you need to understand whether the investment could generate taxable income inside the retirement account. If UBTI applies, the account may have tax-filing and tax-payment obligations. Different retirement arrangements can also be treated differently under these rules.

Ask Before You Invest

- Does this investment expect to generate UBTI or UDFI for retirement-account investors?
- Has the sponsor's tax adviser evaluated the issue?
- Does the sponsor have other retirement-account investors?
- What tax information will be provided?
- Who is responsible for preparing any required retirement-account tax filings?
- Has my own CPA or retirement-account tax adviser reviewed the structure?

07 PRIVATE INVESTMENTS CREATE ADMINISTRATIVE ISSUES

Illiquidity Matters Inside a Retirement Account Too

Private multifamily investments are generally illiquid. That creates additional considerations when the investor is a retirement account.

Valuation

Unlike publicly traded stock, a private partnership interest does not have a readily quoted daily price. Retirement-account custodians have annual reporting responsibilities, so the sponsor or investor may periodically need to provide valuation information.

Required Distributions

Depending on the type of retirement account and the investor's circumstances, required minimum distribution rules may eventually apply. An illiquid investment can complicate those requirements if much of the account's value is tied up in private assets that cannot easily be sold.

Fees

- Account establishment fees
- Annual administration fees
- Transaction fees
- Asset-holding fees
- Wire fees
- Valuation-related fees

08 RETIREMENT ACCOUNT DOES NOT CHANGE INVESTMENT RISK

The Tax Wrapper and the Investment Are Separate Decisions

There are really two decisions.

Decision One: Is This A Good Investment For Me?

- Sponsor
- Property
- Market
- Business plan
- Financing
- Fees
- Return assumptions
- Liquidity
- Downside

Decision Two: Is The Retirement Account The Right Ownership Vehicle?

- Retirement strategy
- Tax consequences
- Prohibited-transaction rules
- UBTI or UDFI
- Liquidity
- Required distributions
- Custodial costs
- Account diversification

Those questions should not be reversed.

A Tax-Advantaged Account Does Not Improve a Bad Investment

Placing an investment inside an IRA does not make an inexperienced sponsor more capable, weak underwriting more conservative, excessive leverage safer, an illiquid investment liquid, or a poor market stronger.

The investment still has to stand on its own merits.

ROBERT'S PERSPECTIVE

START WITH THE INVESTMENT, NOT THE ACCOUNT

I like the flexibility retirement accounts can provide, particularly for investors who have accumulated significant retirement assets and want exposure to investments beyond publicly traded stocks and bonds. But I would never begin with: **"I have money in my IRA. What can I put it into?"**

I would begin with: **"Is this an investment I would be comfortable owning regardless of which account holds it?"**

If the answer is yes, then it makes sense to evaluate whether your retirement account is an appropriate ownership vehicle. I would also involve a qualified tax professional early. The prohibited-transaction and UBTI rules can be consequential, and the right answer can depend on the particular account, investor, and investment structure.

MY RULE

Choose the investment based on its merits. Choose the account based on the tax, retirement, liquidity, and legal considerations that apply to you.

Do not let the availability of retirement capital lower the standard you use to evaluate an investment.

09 QUESTIONS TO ASK BEFORE USING RETIREMENT FUNDS

ABOUT THE ACCOUNT

- Does my retirement account permit private real estate investments?
- Do I need a specialized custodian?
- What fees will the account charge?
- What documentation will the custodian require?
- How will annual valuations be handled?
- Could future distribution requirements create liquidity issues?

ABOUT THE INVESTMENT

- Does the sponsor accept retirement-account investors?
- How should the investment be titled?
- Does the investment expect to generate UBTI or UDFI?
- What information will be provided for tax reporting?
- Could the investment require future capital contributions?
- How would a capital call work for a retirement-account investor?

FOR YOUR PROFESSIONAL ADVISERS

- Could this investment create a prohibited transaction based on my circumstances?
- Could UBTI or UDFI apply?
- How would any resulting tax be reported and paid?
- Is this investment appropriate within my overall retirement strategy?
- Am I concentrating too much of my retirement portfolio in an illiquid private investment?

THE MOST IMPORTANT TAKEAWAY

THE RETIREMENT ACCOUNT IS THE INVESTOR

Using retirement funds for a private multifamily investment can provide another way to hold real estate within a long-term retirement strategy. But it introduces rules that do not apply when you invest with ordinary after-tax funds.

- **The retirement account owns the investment.**
- **Investment money and proceeds generally remain within the account.**
- **The custodian administers the account but does not approve the investment for you.**
- **Prohibited-transaction rules matter.**
- **Leveraged real estate may create additional tax considerations.**
- **Private investments remain illiquid and risky even when held inside a retirement account.**

AND MOST IMPORTANTLY

INVESTMENT FIRST. ACCOUNT SECOND.

Decide whether the investment makes sense first. Then decide whether a retirement account is the right way for you to own it.

RETIREMENT AND TAX EDUCATION NOTICE

Retirement-account rules, tax laws, plan provisions, and individual circumstances vary and may change over time. The availability of a particular investment, tax treatment, prohibited-transaction rules, UBTI or UDFI consequences, and distribution requirements depend on the account, investment structure, and investor.

EDUCATIONAL PURPOSE

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