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Using self-directed IRA funds to purchase income-generating real estate is a profitable strategy an ever-growing number of investors are employing. These accounts (a.k.a. real estate IRAs) can buy rental property as an investment, just as they would buy stock market securities. This means real estate IRA holders can use their retirement funds to purchase real estate without incurring early distribution taxes or penalties and they can realize the rental payments as tax-deferred income within their IRA. The challenge, however, is this: How do you purchase real estate that costs more than the money you've accumulated in your retirement account? Since the Internal Revenue Code prohibits account holders from extending credit (a personal guarantee) to their own accounts, personal loans can't be mixed with IRA funds. So unless you have an IRA flush with funds, it would seem that your purchase options are slim to none. There is a way out of this dilemma. Real estate IRA accounts can make use of borrowed money as long as the credit history, income, and / or assets of the account holder are not used to acquire or guarantee repayment of the loan. There is only one leverage option that meets these criteria: non-recourse loans.

ON-RECOURSE LOANS

A non-recourse loan is (in this case) a loan made to an IRA (not a person), and is based solely on the value of the property acquired with that debt, not the credit of the individual who is the beneficiary of the real estate IRA about to purchase the property. While a non-recourse loan is a boon to those needing the extra cash, there is a bit of a tradeoff. Understandably, banks are averse to risk and, since there is no personal collateral guaranteeing non-recourse loans, they must protect themselves. They have no recourse against the IRA or IRA holder with this kind of loan (hence, the name), so the loan typically comes with higher than normal interest rates, and banks typically require that the IRA provide a high down payment on the real estate - anywhere from 30 to 50 percent. The high down payment is in case of default: If the IRA-purchased real estate has to be foreclosed on, the bank wants to makes sure it has enough equity to cover costs of foreclosing and sale while still retaining a profit.

By David Nilsen, Nuwire