IRA Deal Structuring

Example 1 – The Note for a Rehab

Participants: John, the rehab real estate investor and Pete's IRA that has available funds

The deal: John has a deal under contract. The purchase price for the house is 50K. He will spend 30K on the rehab, and it has an ARV of 130K. A basic rehab deal. He needs the cash to purchase the property and fund the rehab, plus pay for utilities, closing costs, and insurance etc.

Pete's IRA has 100K in money market funds making 1%. He needs a higher return!

The way it works: John signs a note for 84K to Pete's IRA. The notes terms are 12% simple interest to be paid in one year lump sum of $94,080. The note may be prepaid at any time with *no prepayment penalty*, and must be paid upon sale of the property. A mortgage can also be recorded to make Pete's IRA safe. The 84K is funded at closing, so John winds up with cash back at closing to fund the rehab.

Now, John has the money he needs to fund the entire deal. He has no payments to make while he rehabs the house. When the house sells, he lets Pete know and Pete sends him a payment invoice or coupon from his IRA. The money is paid to Pete's IRA at closing. If the deal takes a little over 5 months, let's say 160 days, then the payment is computed as $84,000 + ($29.61 x 160 days = $4,737,75) for a total of $88,737.75. The $29.51 is the daily rate figured as $84,000 x 12% ($10,080) divided by 365 days.

Win/win: John gets to do his deal and make a nice profit. The IRA makes a 12% return on a safe investment.

Example 2 – The JV for Rehab

Participants: Bob the real estate investor and David's IRA

The deal: Bob has a great rehab deal - we will use the same numbers as above. David has an IRA and wants to be involved in the cool world of real estate investing but doesn't have the knowledge. But he does have an IRA with cash!

The way it works: An LLC is formed called "123 Elm Street LLC". In the LLC documents, the Joint Venture is spelled out. The IRA will fund the deal and Bob will manage the rehab and hire an agent to sell it. David's IRA buys 50% interest in the LLC for $84,000. Bob gets 50% interest for assigning his deal plus management. The LLC buys the property. Again, the property is rehabbed and sold. The money at closing goes to 123 Elm Street LLC. A profit of $32,000 is computed. 123 Elm Street pays Bob 16K for his 50% ownership and David's IRA gets 16K as well, plus its 84K back.

Win/win: Bob gets to do a deal with no money out of his pocket, a deal he wouldn't have been able to do without the JV. David's IRA makes 16K on 84K in just under 6 months. That's a return of around 38%!!

What's the difference is this and the note? On this deal the IRA is at risk. If the deal goes bad and makes only 5 grand, then the IRA makes $2500 on an $84,000 investment – only a 6% return. Or worse yet, it the deal loses 5K then the IRA loses $2500 and Bob has to lose $2500 as well. Using the note, if the deal lost 5K Bob would lose 5K plus the $4737.75 so almost 10 grand. This is why when using the JV the IRA investor should make more as the risk is much higher.

I used 50/50 but it can be any percentage agreed to. If they agreed to a 60/40 split and the deal made the 32K profit, Bob would get $19,200 and David's IRA would get $12,800 – still a 30% return for the IRA. At 70/30, it would be Bob $22,400 and the IRA $9,600 which even at 70/30 is a 22% return for the IRA.

Example 3 – The Long Term Rental

Participants: Harry the real estate investor and Susan's IRA

The deal: Harry has found a killer rental duplex. He wants to own it but is adverse to borrowing money. Harry has $4000 he can invest but that's it.

The property can be purchased for 40K and needs 20K in rehab. We will factor in another 4K for closing costs and expenses during the rehab. So total needed is 64K. It will rent for $800 per side and he believes that after all expenses including management it will average $11,000 per year cash flow.

Harry offers to let Susan's IRA own 60% of this deal for $60,000. The IRA will receive 60% of the average $11,000 per year which is $6,600. Since the IRA invested $60,000 it will average 11% on a property that is fully managed. Harry, on the other hand, will receive 40% of the cash flow - an average of $4,400 per year on an investment of $4,000. That return is, well, damn good!

The way it works: An LLC called "Duplex 1" is formed. Susan's IRA invests $60,000 for a 60% interest. Harry invests his $4,000. Duplex 1 buys the property. Harry runs the rehab then hires a management company to run then do the property management. The management company sends the money monthly to Duplex 1. Harry, as manager of Duplex 1 pays both he and Susan's IRA monthly according to their percentage ownership.

Win/win: Susan's IRA gets a safe 11% return long term year after year. Plus, the property is sold later for say $90,000, she will get 60% of the profit after expenses which would raise her return as well. Harry gets to invest what paltry cash he has at over 100% returns and 40% of any upside if they ever decide to sell it. You can see how Harry could do this again and again, making $250- $500 per month per deal. If he were to do 10 of these over the next 5 years or so he could wind up with a nice $4000 a month in residual income from property he doesn't even manage. Plus he might build up 100K in equity.