

## **BUSINESS WEEK ONLINE**

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BY TODDI GUTNER

### **Blaze Your Own IRA Trail**

With a "self-directed" account, your funds can seek out unconventional investments

Until nine months ago, Hal Fong had a fairly typical individual retirement account (IRA) with all the usual vehicles: mutual funds, stocks, and bonds. Then he finally got tired of the so-so returns. So using a "self-directed IRA," he directed 20%, about \$125,000, into a private-equity deal, Pan Pacific Bank, a Fremont (Calif.) startup. Fong, a 51-year-old logistics manager at Home Depot (HD ) in Northern California, expects the bank to be bought, merged, or taken public within three years, earning a 30% average annual return for his IRA.

More and more people are putting retirement dollars into everything from startups and real estate to race horses. (Life insurance and collectibles are the only investments prohibited in an IRA.) "For some investors, stocks and bonds don't make sense, and they're just more comfortable in other assets," says Paul Maxwell, chief operations officer of Trust Administration Services, one of the custodial firms that handles the paperwork for such accounts.

Not everyone thinks it's a good idea. Such strategies can backfire for reasons unrelated to investing, says Ed Slott, an IRA consultant in Rockville Centre, N.Y. "There are a whole set of rules for self-directed IRAs, which require investors to be extremely careful," he says.

### **LOOKS FISHY**

The biggest risk is "self-dealing," meaning that you've effectively used these tax-deferred funds for current use. Say you take \$100,000 from your \$1 million IRA to buy property on which you hunt and fish. If the Internal Revenue Service finds out about your personal use of the land, the entire \$1 million could be considered distributed, and all the money subject to income tax and withdrawal penalties for account owners younger than 59 1/2. Slott says you shouldn't even let family members use the property, or any other asset in a self-directed IRA. The IRS may decide that there is a benefit to you.

Creating a self-directed IRA is easy. You can ask a bank's trust department or sign up with a custodial firm (table). They keep the books, disburse money, and collect profits for the IRA, but they may not give investment advice. Make sure the

account holds enough cash to meet fees and expenses. Trust Administration Services, for example, charges \$35 to open an account, a \$150 yearly record-keeping fee, transaction fees of \$5 to \$250, and an annual asset-holding fee of \$10 to \$80. For real estate investments, you may also need annual appraisals.

If you're opting for a self-directed plan, be prepared to do a lot of homework -- or pay someone you trust to do it for you. Dennis Geraghty, a 59-year-old brand consultant in Monroe Township, N.J., spent six months doing research and ultimately invested \$250,000 -- half of his IRA -- with a real estate developer who is building a 14-unit luxury condominium in Brooklyn, N.Y.

Geraghty also took some smart measures to make sure the investment worked well. First, he split off money from his existing IRA and transferred that part into his new self-directed account. "This way, if there are any problems, all the retirement money isn't at risk," says Slott. Geraghty also invested alongside outside partners who would have a substantial ownership piece. This is especially important if you're using a self-directed IRA to start and operate a small business. Geraghty expects his investment will pay off in two years, which is well before he will need the money at age 70 1/2, when IRA owners must start taking distributions. (Some investors use rental income from IRA properties for their distributions.)

By committing half of his IRA, Geraghty is making a big bet. Most advisers would counsel IRA owners to keep such investments to the 10%-to-20% range, as did Hal Fong. After all, you want to make sure your retirement money is there when you need it.

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