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Securing your IRA's Loan

Making loans to people or businesses from a Self Directed IRA can be a easy and safe way to earn a fair and sometimes even a generous return.

It can make a lot of sense to make loans using IRA dollars. When you lean "personal' money the interest income is all taxable in the current period thus your net return will be less than the return stated in the note. However, if your IRA makes that same loan and earns the same return the income is 100% income tax deferred (or in the case of a Roth IRA the income may be 100% income tax free.

However, making a loan is the same as making an "investment" and all investments have risk. By taking a few simple steps at the very beginning of the lending process you can do a great deal (for you and your IRA) to reduce and in some cases almost eliminate risk.

> When working on a weapons treaty with the former Soviet Union President Reagan famously said "Trust but Verify". This applies to your IRA when it is the lender.

Ask Questions. Remember the last time you borrowed from a bank, they asked every question they could think of. (How many pairs of socks do you own?). Then they asked you to verify your response. Now your IRA is the Bank. Don't be shy, ask your questions. If you do not like the answers, now may be a good time to walk away.

0. Let's start with: Why is this person borrowing? Does it make good business sense?

1. The promissory note. You can down load notes from the web or a better option is to have a local attorney draft a Promissory Note between your IRA account and the borrower. This may cost only a few hundred dollars and can be money well spent.

   NOTE: It is okay to require the borrower to pay the cost of drafting the Note (up to a certain limit say $300).

2. Require Payment. Many borrowers want to pay everything (the principle and interest) at the end of the period in one large final payment (sometimes called a Balloon Payment); And in some cases this makes sense. However, a better option (for the lender [your IRA]) is to get the borrower into the habit of making payments. You can do this by requiring monthly or quarterly payments. The payments may be interest only but, getting regular payments helps to keep the idea of repayment foremost in the borrowers mind.

3. Hard Money: In some cases you may not care about a person's credit history if your IRA has enough collateral. When your IRA is relaying on the value of the collateral; the loan is referred to as a Hard Money loans because there is a hard asset securing the debt. If payment is not made; the lender takes the asset.

   Note: if your IRA is about to make a "hard money loan" we encourage you to have a local attorney draft the loan document. The attorney will verify if the borrower actually owns the collateral and if there are mortgages or liens that must be paid before your IRA can collect.