IRA Loanâ€”Loan-to-Value Ratio

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When you apply for a non recourse loan against your self-directed IRA, the lender will examine the proposed loanâ€™s LTV (loan-to-value) ratio before extending a loan. The LTV ratio enables lenders to assess risk on the loan. The loan-to-value ratio usually applies to loans borrowed for property investment. Because an IRA loan for property purchase falls in this category, it helps to know what kind of LTV ratio lenders expect for approving a loan request.

An IRA loan is riskier to lenders because the IRS requires it to be non recourse. This means it frees the borrower from personal liability in the event of loan default. Therefore, lenders usually offer an IRA loan only when the loan-to-value ratio does not exceed 65% for single family homes.

For condominiums, multi-unit properties, and apartment complexes, the loan-to-value maximum is lower, at around 60%.

Calculating Loan to Value

To assess if your IRA loan proposal is feasible, find out the loan-to-value for the IRA loan. Typically, the loan-to-value is the ratio of the loan amount to the value of the property.

Therefore, if you want to purchase property worth $100,000 and expect to borrow an IRA loan of $85,000, the loan-to-value ratio would be 85%. The LTV is too high, and it is unlikely that your loan application would be approved.

Take another example. If you want to buy the same property (worth $100,000) and need a loan of $65,000, the loan to value is 65%. This increases the likelihood of a favorable response from the IRA loan provider.

If you are planning to borrow $70,000 to purchase a condominium worth $100,000, the loan-to-value ratio is 70%. This is higher than the acceptable LTV on condominiums and multifamily dwelling units. However, if you are willing to offer a down payment of $40,000 and borrow only $60,000, the loan-to-value ratio becomes 60%, and the lender might be more willing to consider your loan request.

The loan-to-value cap may also be lowered if the lender feels that the property is a risky investment; that is, it does not yield good returns, requires too much investment, and cannot fetch sufficient rental. Other reasons for a reduced LTV could include poor condition of the property, a unique property, or unimproved property (land).

Investing Smartly

Usually, it is a good idea to scrape together the funds without taking out a non recourse loan if possible. Some people partner with relatives; others may clear out their savings to come up with the required capital. However, getting hold of the money through these channels is often difficult.

Many people are unaware that, in this situation, they can finance the property purchase in the self-directed IRA by getting a non recourse loan. While the lender provides 65% of the property price, you can use your IRA to fund the remaining 35%. Though this loan does not put IRA assets at risk, remember that it does put your IRAâ€™s future ability to obtain a loan at some risk, so you have to invest wisely. Choose a property that requires minimum operating expenses such as maintenance,

security, utility bills, tax, etc. and offers maximum returns in rent.

Before you approach the lender for an IRA loan, you need to have a self-directed IRA with at least the 35% of the property price invested in it.

A self-directed IRA loan allows the investor to buy property within an IRA without putting the IRA at risk (the property you buy can be foreclosed, but other IRA funds are not at risk from lenders). Because your IRA is also funding a portion of the investment, you need to select the property cautiously.

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