

The truth about "nothing down"

Contributed by Travis Morien

When I read Rich Dad, Poor Dad for the first time, long before I started on this website, I did not know anything about real estate. I became excited at the prospect of being able to buy houses without so much as a cent in my pocket, and sell them on at large profits shortly after. Kiyosaki talks about doing this via lease options. He tells of all the deals he has supposedly done where he found a very cheap property, set up a lease option on the place and immediately found another investor willing to pay a higher price for it, exercised his lease option and sold to the next guy with a fat, instantaneous and risk-free profit.

As soon as I finished the book I started researching real estate. Lease options are often the centrepiece of grand wealth building strategies put out by real estate gurus who charge tens of thousands of dollars for seminars, "courses" and "boot camps". The trouble with them is that they rely on matching up a naïve or desperate vendor with a greedy and ignorant speculator. Apart from being morally reprehensible as you can see some elderly couple out of thousands of dollars, you must first have some fool to offload your property on at this inflated price. Lease options are a method where you agree to pay (an often inflated) rent on a property, with the option of purchasing that property at a later date, at a fixed price. Kiyosaki talks about them all the time in his books, and makes it all sound like it is just the most normal thing in the world for a financially savvy person to do. For someone who takes out a lease option you are often stuck with paying an inflated price for rent, those who pursue this strategy often walk away from the lease option after a few years as they find better value elsewhere. Lease options are most usually seen as a method of exploiting someone that cannot afford a downpayment on a first home.

In Australia lease options are not used very often, I have talked with a few real estate agents and this is just not how we do things locally. It is like hire-purchase on a home, you pay a high rent on the place which counts as equity (sometimes) with the option writer, and this is deducted from the inflated price you pay for the final product. Many of Kiyosaki's deals would be downright illegal in Australia (and I am not too sure about America at that), other deals he writes about in his book simply make no sense at all financially. The Rich Dad, Poor Dad books are among the best selling personal finance titles in the world today, he has written a number of books (all of which contain the same old message repackaged over and over) and operates something of a cult of personality - people like the guy and trust him because they like him. I strongly suspect that if indeed Kiyosaki really is a millionaire, it is because that Cashflow 101 board game of his costs a couple of hundred dollars, he charges over \$10000 for super investor seminars in Hawaii, and he has written at least four provocatively titled and marketed bestsellers. Many experienced real estate investors from America regard him as a fraud who peddles dangerous advice to people who don't do their homework, as far as I can tell his material is no better on our side of the pond than it is over there.

There are other zero-down methods, you will find out about them if you surf the American real estate guru sites, but none of them are really a good idea. Proper zero down deals mean you borrow 100% of the value of a property, not securing the loan against any other equity. This violates sensible lending practice, unless you have significant collateral behind the loan you will not be lent that much money. Kiyosaki implies in his books many times that the truly smart investor is able to do deals to make immediate and risk-free profits out of zero-down. This is wrong. There is a perfectly good reason why few lenders will give 100% of the value of a property unless you can secure it against something else, that reason is that failure to be conservative is guaranteed to send a bank broke in a few years. If you do find someone willing to lend 100% you may have to pay very high interest rates and may well have to face the prospect of the property being repossessed. Taking on such high levels of debt is reckless and in that respect Kiyosaki is a truly terrible teacher for giving this as advice. Even if you are the type of person who has no objections to ripping people off, I suggest finding some other racket, zero-down purchasing strategies have landed many Americans in jail, they often involve lying to a lender, and many times that number of bankruptcies.

If you really want to do "zero-down" investing the way to do it is via building up equity in your own home first. If you have significant equity in your own home you can borrow against it, and you frequently won't need to pay a deposit. It isn't so sexy as the schemes peddled by those who would like you believe that rags to riches is just the easiest thing in the world to do, but this is how it is usually done. If you want to go from rags to riches, get an education and study investment. If you are thrifty you can make do with just about any job and get a first home. Once you have that home you are well on your way. You should note though, that actually borrowing on your equity is not zero-down dealing as it is usually defined, your deposit comes from the existing equity. Zero-down means having a 100% loan to value ratio, but if you have equity in your own home then this is not 100%. The equity increase in your own home is a major reason why Kiyosaki's message that a home is not an asset is wrong, the cashflow definition of an asset is Kiyosaki's (though he probably pinched the idea, none of his stuff is really all that original), an asset is defined as something that can produce future economic benefit. The buildup of equity in your home that comes from your own payments, inflation pushing up the price of your home and inflation devaluing your mortgage, as well as the 100% CGT free nature of a private residence really DOES make owning your own home a very wise investment for anyone without a pressing reason to rent (ie the need for mobility, if you are regularly transferred), though of course unless you are always selling your home at a profit and then moving into a cheaper one this by itself won't create wealth.

