NO MONEY DOWN

NO CREDIT REQUIRED

BY BEST-SELLING AUTHOR AND AUTTORNEY

WILLIAM BRONCHICK

INTRODUCTION

Do you want more in life? Is your job a hassle and a continuing source of stress? Do you feel like you are working a lot, under a ton of pressure and not having much time to spend on yourself or your family? Are there things that you would really like to provide for them but just can't seem to pull it off?

Real Estate just might be the answer! Real estate can be done part or full time. Did you know that more millionaires are made through real estate than any other means?

Think about what your life could be. Wouldn't it be nice to enjoy just a few of the nicer things of life, to be able to afford a decent school for your kids or grandkids? How great would it be to have the time and resources to be able to take a good vacation once in awhile? Wouldn't it be nice to have a business that produces income even if you aren't working that day, that week, or even that month? Real estate just could

be the answer!

The one thing that holds new or would-be investor back is the myth that you need a lot of money or the ability to borrow from banks to buy real estate. While cash and credit are useful, they should not prevent you from buying real estate to create cash flow, equity, and retirement security. This book explains how you can buy real estate without credit, without banks, and with little or no cash out of pocket.

Chapter One: Introduction to Real Estate Financing

Knowledge is power.

—Francis Bacon

Financing has traditionally been, and will always be, an integral part of the purchase and sale of real estate. Few people have the funds to purchase properties for all cash, and those that do rarely sink all of their money in one place. Even institutional and corporate buyers of real estate use borrowed money to buy real estate.

This book explains how to utilize real estate financing in the most effective and profitable way possible. Mostly, this book focuses on acquisition techniques for investors, but these techniques are also applicable to potential homeowners.

As with any technique on real estate acquisition or finance, you should review the process with a local professional, including an attorney. Also, keep in mind that while most of these ideas are applicable

nationwide, local practices, laws, rules, customs, and market conditions may require variations or adaptations for your particular use.

Understanding the Time Value of Money

In order to understand real estate financing, it is important that you understand the time value of money. Because of inflation, a dollar today is generally worth less in the future. Thus, while real estate values may increase, an all-cash purchase may not be economically feasible, because the investor's cash may be utilized in more effective ways.

The cost of borrowing money is expressed in interest payments, usually a percent of the loan amount. Interest payments can be calculated in a variety of ways, the most common of which is simple interest. Simple interest is calculated by multiplying the loan amount by the interest rate, then dividing it up into periods, (12 months, 15 years, etc.).

Example: A $100,000 loan at 12% simple interest is $12,000 per year, or $1,000 per month. To calculate monthly simple-interest payments, take the loan amount (principal), multiply it by the interest rate, and then divide by 12. In this example, $100,000 · .12 = $12,000 per year | 12 = $1,000 per month.

Mortgage loans are generally not paid in

simple interest but rather by amortization schedules, calculated by amortization tables. *Amortization,* derived from the Latin word “amorta” (death), is to pay down or “kill” a debt. Amortized payments remain the same throughout the life of the loan but are broken down into interest and principal. The payments made near the beginning of the loan are mostly interest, while the payments near the end are mostly principal. Lenders increase their return and reduce their risk by having most of the profit (interest) built into the front of the loan.

The Concept of Leverage

Leverage is the process of using borrowed money to make a re- turn on an investment. Let’s say you bought a house using all of your cash for $100,000. If the property were to increase in value 10 percent over 12 months, it would now be worth $110,000. Your return on in- vestment would be 10 percent annually (of course, you would actually net less because you would incur costs in selling the property).

Equity = Property value – Mortgage debt

If you purchased a property using $10,000 of your own cash and $90,000 in borrowed money, a 10 percent increase in value would still result in $10,000 of increased equity, but your return on cash is 100

percent ($10,000 investment yielding $20,000 in equity). Of course, the borrowed money isn't free; you would have to incur loan costs and interest payments in borrowing money. However, by renting the property in the meantime, you would offset the interest expense of the loan.

Calculating Return on Investment

Annual return on investment (ROI) is the interest rate you yield on your cash investment. It is calculated by taking the annual cash f low and/or equity increase and dividing it by the amount of cash invested. Return on investment includes the equity increase, whereas "cash-on-cash" is simply cash invested divided by annual cash f low. The cash-on-cash formula is affected by your operating expenses on the property, as well as payments you make for interest on your loan, which in turn affect your cash f low.

Let's also look at the income versus expense ratios. If you purchased a property using all cash for $100,000 and collected $1,000 per month in rent, your annual cash-on-cash return is 12 percent (simply divide the annual income, $12,000, by the amount of cash invested, $100,000).

If you borrowed $90,000 and the payments on the loan were $660 per month, your annual net income is $4,080 ($12,000 – [$660 x 12]), but your

annual cash-on-cash return is about 40 percent (annual cash of $4,080 divided by $10,000 invested).

Thus, if you purchased ten properties with 10 percent down and 90 percent financing, you could increase your overall profit by more than threefold.

Owning Property “Free and Clear’

For some investors, the goal is to own properties “free and clear,” that is, with no mortgage debt. While this is a worthy goal, it does not necessarily make financial sense.

☛ **Example:** Consider a $100,000 property that brings in $10,000 per year in net income (*net* means gross rents collected, less expenses, such as property taxes, maintenance, utilities, and hazard insurance). The $100,000 in equity thus yields a 10 percent annual return on investment ($10,000, the annual net cash f low, divided by $100,000, the equity investment). This formula is the property’s capitalization or “cap” rate, which has nothing to do with the mortgage payments for the property or the amount of cash you have invested. The reason investors use cap rate is to compare potential return on investment with other investments, without regard to the financing on the property. However, cap rate alone is not necessarily the only

factor to consider. For example, if one property has a cap rate of 7% and another property has a 11% cap rate it would seem obvious that the higher cap rate would be desirable. This is not necessarily so because with a higher cap rate can come higher risk. You must determine if you are comfortable with higher risk associated with higher cap rate.

How Financing Affects the Real Estate Market

Because financing plays a large part in real estate sales, it also affects values; the higher the interest rate, the larger your monthly payment. Conversely, the lower the interest rate, the lower the monthly payment. Thus, the lower the interest rate, the larger the mortgage loan you can afford to pay. Consequently, the larger the mortgage you can afford, the more the seller can ask for in the sales prices.

Also, people with less cash are usually more concerned with their payment than the total amount of the purchase price or loan amount. On the other hand, people with all cash are more concerned with price. Because most buyers borrow most of the purchase price, the prices of houses are affected by financing. Thus, when

interest rates are low, housing prices tend to increase, because people can afford a higher monthly payment. Conversely, when interest rates are higher, people cannot afford as much a payment, generally driving real estate prices down.

How Financing Affects Particular Transactions

When valuing residential properties, real estate appraisers generally follow a series of standards set forth by professional associations (the most well known is the Appraisal Institute). Sales of comparable proper- ties are the general benchmark for value. Appraisers look not just at housing sale prices of comparable houses, but also at the financing associated with the sales of these houses. If the house was owner-financed, the interest rate is generally higher than conventional rates and/or the price is inflated. The price is generally inflated because the seller's credit qualifications are looser than that of a bank, which means the buyer will not generally complain about the price.

Take a Cue from Other Industries

The explosion of the electronics market, the automobile market, and other large-ticket purchase markets is directly affected by financing. Just thumb through the Sunday newspapers and you will see headlines such as "no money down" or "no payments for one year." These retailers have learned that financing moves a product because it makes it easier for people to justify the purchase. Likewise, the price of a house may be stretched a bit more when it translates to just a few dollars more per month in mortgage payments.

Appraisals on income properties are done in a variety of ways, one of which is the “income” approach. The *income approach* looks at the value of the property versus the rents the property can produce. While financing does not technically come into the equation, it does affect the property’s profitability to the investor. Thus, a property that can be financed at a lower interest rate will be more attractive to the investor if cash f low is a major concern. The income approach is not generally used by appraisers for properties of four units or less.

Tax Impact of Financing

Down payments made on a property as an investor are not tax-deductible. In fact, a large down payment offers no tax advantage at all because the investor’s tax basis is based on the purchase price, not the amount he or she puts down. However, be- cause mortgage interest is a deductible expense, the investor does better tax wise by saving his or her cash. Think about it: the higher the monthly mortgage payment, the less cash f low, the less tax- able income each year. While positive cash f low is desirable, it does not necessarily mean that a property is more profitable because it has more cash f low. A larger down payment will obviously in- crease monthly cash f low, but it is not always the best use of your money.

How Real Estate Investors Use Financing

As discussed above, investors use mortgage loans to increase their leverage. The more money an investor can borrow, the more he or she can leverage the investment. Rarely do investors use all cash to purchase properties, and when they do, it is on a short-term basis. They usually refinance the property to get their cash back or sell the property for cash.

The challenge is that loans for investors are treated as high-risk by lenders when compared to non-investor (owner-occupied proper- ties) loans. Lenders often look at leveraged investments as risky and are less willing to loan money to investors. Lenders assume (often correctly) that the less of your own money you have invested, the more likely you will be to walk away from a bad property. In addition, fewer investor loan programs mean less competition in the industry, which leads to higher loan costs for the investor. The goal of the investor thus is to put forth as little cash as possible, pay the least amount in loan costs and interest, while keeping personal risk at a minimum. This is quite a challenge, and this book will reveal some of the secrets for accomplishing this task.

When Is Cash Better Than Financing?

Using all cash to purchase a property may be better than financing in two particular situations. The first situation is a short-term deal, that is, you intend to sell the house shortly after you buy it (known as "flipping"). When you have the cash to close quickly, you can generally get a tremendous discount on the price of a house. In this case, financing may delay the transaction long enough to lose an opportunity. Cash also allows you to purchase properties at a larger discount. You've heard the expression, "money talks, BS walks." This is particularly true when making an offer to purchase a property through a real estate agent. The real estate agent is more likely to recommend to his or her client a purchase offer that is not contingent on the buyer obtaining bank financing.

The second case is one in which you can use your retirement account. You can use the cash in your IRA to purchase real estate, and the income from the property is tax-deferred (or even tax-free, if you have a Roth IRS). Watch this informative video for a detailed explanation:

http://www.bronchicklaw.com/checkbook-IRA

Chapter Two: Hard Money and Private Money

A loan shark is simply a thief without a Wall Street office.

—Lyndon H. LaRouche Jr.

An often overlooked and very valuable source of funding is private money. Small companies and individual investors called “hard- money lenders” are an excellent resource for quick cash. Private lenders are often known as hard- money lenders because they charge very high interest rates. Hard money is often called “bridge” or “mezzanine” financing, which is more palatable. I have personally borrowed at 18 percent with 8 points as an origination fee! These rates may sound outrageous at first blush, but it is the availability of the money not the cost that matters.

Emergency Money

I recently won with the high bid on a condominium auctioned by the Department of Veterans Affairs (VA). I made the bid in the name of a corporation rather than my individual name. I was assured by my mortgage broker that the lender that had my loan application would permit me to finance

the purchase in a corporation. At the eleventh hour, the lender changed its mind, requiring me to close in my individual name. I asked the VA for permission to amend the purchase contract to name me, rather than my corporation. The VA refused, and I now had less than five days to close or lose the deal. Because my winning purchase bid was an excellent price, I opted for using hard money to purchase the property. I paid 14 percent interest for a few months, then refinanced the property at a good interest rate. All in all, the high cost of the hard-money loan was worth it and saved me in a pinch.

Hard- money lenders can be expensive but also easy to deal with if you are in a hurry for the money. In many cases, the availability of the money is more important than the cost of borrowing it.

Borrowing from Friends and Relatives

Friends and relatives seem like obvious choices for borrowing money, but they may be as skeptical as an institutional lender. They may try to boss you around and nag you about when you expect to repay the money you borrowed. They may also want to be part of the daily decision-making process, which would interfere with your business. And, of course, they may be emotional about their money, whereas institutional lenders don't take money matters personally.

Borrower Beware! Soliciting money from private investors can be a dangerous practice. Federal securities laws may apply to public solicitations of money as a "public offering." In addition, state securities regulations (known as "Blue Sky Laws") may also apply. Simply running a blind ad in the paper stating, "Private Money Wanted for Real Estate Purchase—12% Return" may result in a call from your state securities regulation office. If you are approaching a friend, relative, or individual investor to borrow money secured by a specific property, then you are probably OK; borrowing money for a "pool" of funds becomes trickier. Also, when you deal with strangers, multiple par- ties, or the public at large, you should seek the advice of a local attorney knowledgeable about state and federal securities regulations.

Using Lines of Credit

A home equity line of credit (HELOC) can be an excellent financing tool, if it is used properly. A HELOC is basically like a credit card secured by a mortgage or deed of trust on your property. In most cases, it will be a second lien. You only pay interest on the amounts you borrow on the HELOC. You can access the HELOC by writing checks provided by the lender.

HELOCs are being advertised on television as a way to consolidate debt, but they can be used

much more effectively by investors. When you need cash in a hurry for a short period of time, a HELOC can be very useful. For example, if a seller tells you to give him "$75,000 cash on Friday and I'll sell you my house for a song," you need to act in a hurry. Another example of cash in a hurry is a foreclosure auction, which, in many states, requires payment at the end of the day of the auction. When you need cash in a hurry, there's no time to go to the bank.

While the HELOC may be a high-interest-rate loan, it is a temporary financing source that can be repaid when you refinance the property. *Do not use your HELOC as a permanent down payment or any other long-term financing source—it will generally get you into financial trouble.* Furthermore, some institutional lenders may not lend you the balance if you borrowed the funds for the down payment. Other lenders allow you to borrow the money from your HELOC but count the borrowed money against your debt-to-income ratio. You also need to count this debt against any property you purchase to determine cash flow.

Warning: Failure to pay your HELOC means you lose your home! Use your HELOC wisely and only if it means losing a steal of a deal if you don't!

Credit Cards

You may already have more available credit than you realize. Credit cards and other existing revolving debt accounts can be quite useful in real estate investing. Most major credit cards allow you to take cash advances or write checks to borrow on the account. The transaction fees and interest rates are fairly high, but you can access this money on 24 hours' notice. Also, because credit card loans are unsecured, there are no other loan costs normally associated with a real estate transaction, such as title insurance, appraisals, pest inspections, surveys, etc.

Often, you will be better off paying 18 percent interest or more on a credit line for three to six months than paying 9 percent interest on institutional loans that have up-front costs that would take you years to recoup. Again, use credit cards carefully and only as a temporary solution if the deal calls for it.

Chapter 3: Partnerships and Equity Sharing

The guy with the experience approaches the guy with the money. When the deal is complete, the guy with the experience has the money, and the guy who had the money has experience.

—Anonymous

If you are low on cash or have cash and are low on time, a partnership or equity- sharing arrangement may be for you. Using partners to finance real estate transactions is the classic form of using other people's money (OPM). Experienced investors are always willing to put up money to be a partner in a profitable real estate transaction. As with many businesses, talent is more important than cash. If you can find a good real estate deal, the money will often find its way to you!

Partnership arrangements work in a variety of circumstances. The most common scenario involves one party living in the property while the other does not. Another scenario may involve all of the par- ties living in the property. These arrangements are common among family members. Parents often lend

their children money for a down payment on a house, with a promise of repayment at a later date. If the repayment of the debt is with interest and/or relates to the future appreciation of the property, we have a basic equity- sharing arrangement.

Another common financing arrangement between multiple parties is a partnership wherein none of the parties live in the property. This chapter will discuss the basic partnership investment. Larger investments through limited partnerships and other corporate entities in a "pool" of money are known as "syndications." These investments are generally classified as securities, so compliance with state and federal regulations is complex. Thus, syndications are generally not recommended for financing smaller projects because the legal fees for compliance with securities laws will far exceed the benefit of raising capital through multiple investors.

Basic Equity-Sharing Arrangement

The common equity-sharing arrangement involves one party living in the property and the other putting up cash and/or financing. Both the occupant and the nonoccupant enjoy tax benefits and share the profit, as described later in this chapter. First- time homebuyers make the best resident partners while family members, sellers, and real estate investors fill the nonresident partner role.

Scenario #1: Buyer with Credit and No Cash

A lot of potential homebuyers have the income to qualify for a mortgage loan, but only with a substantial down payment. With a small down payment, the monthly loan payments may be too high. A potential homebuyer could borrow the money for the down payment, but nobody but a fool (or a parent) would lend $25,000 or more unsecured. Furthermore, loan regulations generally do not permit the use of borrowed money as a down payment equity- sharing partner could put up the money in exchange for an interest in the property. The resident partner would obtain the loan, live in the property, make the monthly loan payments, and maintain the property. The nonresident partner who puts up the down- payment money is free from management headaches and negative cash flow. After a number of years (typically five to seven), the property is sold, the mortgage loan balance is paid in full, and the profits are split between the parties. Obviously, the strategy works best in a rising real estate market.

Scenario #2: Buyer with Cash and No Credit

The second equity-sharing scenario would be a buyer with cash but an inability to qualify for institutional financing. The resident partner would put up the down payment, the nonresident

partner would obtain the loan. After a number of years, the property is sold, the mort- gage loan balance is paid in full, and the profits are split between the parties.

Alternatives to Equity Sharing

For the nonresident investor, there are several alternatives to the equity-sharing arrangement. The first is the lease option, which is discussed in more detail in my **Creative Real Estate Financing Course.** The second is a joint venture.

Joint Ventures

Joint venture partnerships can be an excellent way to finance a real estate transaction, and they can be handled in a variety of ways. The most common is where one partner puts up cash and the other puts up his or her interest in the deal and/or his services in managing the property. The joint venture agreement will spell out how the money is contributed and how it is disbursed. Title to the property is generally held in the name of the joint venture, although title can be taken in the name of one or both of the partners. Using a partner to finance deals can be very effective on a deal-by-deal transaction.

Sometimes a joint venture partnership looks more like a general partnership because it is not

specific to any one particular property. For example, an investor, or group of investors, may "pool" money together for the purchase of properties at a foreclosure auction. This type of arrangement should be approached with extreme caution because it looks more like a general partnership than a joint venture. It also may cross over into securities regulations, particularly if you are the one soliciting money from other investors.

Chapter Four:
The Lease Option

The road less traveled is that way for a reason.

—Fortune Cookie

The lease-option strategy is a great way to leverage your real estate investments because it requires very little cash. The lease-option method is more of a financing alternative than a financing strategy because you don't own the property.

The basic lease- option strategy involves two legal documents, a lease agreement and an option. A lease gives you the right to possess the property, or, as an investor, to have someone else occupy it. If you can obtain a lease on a property at below market rent, you can profit by subleasing it at market rent.

An *option* is the right to buy a property. It is a unilateral or one- way agreement wherein the seller obligates himself or herself to sell you the property, but you are not obligated to buy it. By obtaining the right to buy, you control the property. You can market the property and sell it for a profit. The

longer you can control the property in an appreciating market, the more value you create for yourself. By combining a lease and an option, you create a lease option.

Financing Alternative

The two primary objectives of the real estate investor are cash flow and appreciation. You don't need to own a property to create cash f low or benefit from appreciation. Because a lease entitles you to possession, it allows you to create cash flow. An option gives you the right to buy at a set price, allowing you to benefit from future appreciation.

Lease Option of Your Personal Residence

Pride of ownership is what makes so many Americans obsessed with the idea of owning a home. Once you get over this idea, you will see that you can often rent more home than you can buy.

Why buy when you can rent? We've all seen the ads used by real estate agents: "Why rent when you can buy?" Consider the other side of the coin: "Why buy when you can rent?" In most parts of the country, a typical $100,000 house will rent for about $1,000 per month. Assuming a reasonable down payment and interest rate, the monthly mortgage payments would be less than

$1,000 per month. In this case, it makes sense to own the home. However, more expensive homes don't rent as well as cheaper homes. A typical $500,000 home does not rent for $5,000 per month. The more expensive the home, the cheaper it be- comes to rent compared to buy. If you are concerned about the proverbial "throwing away rent," consider a lease option of your next home.

The Sandwich Lease Option

The sandwich lease option is an old technique used by real estate entrepreneurs to create cash, cash flow, and equity buildup with literally no money, credit, or bank loans.

Let me give you a typical example of how a sandwich lease option works. A seller (soon to be *landlord*) is transferred out of town and rents his property. A year later, the tenant vacates (after skipping a few months rent) and leaves a big mess. The owner wants to sell the property for $110,000. It is the middle of the winter, the house is vacant, and the real estate market is a bit slow.

The house needs new paint and carpet and therefore looks ugly. The $850 per month mortgage payment is a burden to the owner. He decides to lease it on a month- to- month basis but cannot find a tenant because nobody wants to lease a house for sale when he or she may have to leave within a few months. The owner is a perfect

candidate for a lease option.

The potential buyer (a.k.a. tenant) filed for bankruptcy two years ago. He just moved to town. Although he has stable income, he cannot yet qualify for a loan. In addition, he still has to sell his old house to raise some cash for the down payment. He doesn't really want a straight rental, yet he is not ready to buy today. The tenant is a perfect candidate for the other end of a lease option.

Cash Flow

So how do we, as real estate investors, fit in? Find the owner who fits the picture and sign up a lease- option agreement wherein you are the tenant/buyer. You are not going to live in the property but are still considered a "master tenant." The lease-option agreement will give you the right to sublet the property. If the price you pay is lower than market rent, you can create cash f low by subletting the property to another tenant. Depending on the deal, this can create several hundred dollars per month of cash flow—not bad for a property you don't even own! Of course, these are round numbers using a $100k property – imagine the cash flow in a market where the average property is $500k!

Equity Buildup

After a year or two, you may have accumulated some equity in one of the following ways:

- Appreciation of the property due to inflation
- Increase in value from improvements on the property
- Increase in equity from rent credits offered by the landlord/ seller

Once your *equity,* the difference between the market value and your option strike price, reaches around 10 percent, you can obtain lender financing and buy the property. Or, you can offer the property for sale to another investor. Better yet, offer the property for sale to the tenant. In many cases, a tenant/buyer is willing to pay more than the property is worth! When the tenant is ready to exercise his option, you exercise your option from the owner and sell it to the tenant in a back- to-back double closing for a profit.

About the Author

William Bronchick, host of Legalwiz.com, is a nationally known attorney, author, entrepreneur and speaker. He has been practicing law and investing in real estate since the early 90's, having been involved with thousands of real estate transactions. He has trained countless people all over the Country to become financially successful, speaking to audiences of over 16,000 at mega-events, sharing the stage with names like Rudy Guliani, Steve Forbes and Colin Powell. His bestselling book, "Flipping Properties", was named one of the ten best real estate books of the year by the Chicago Tribune.

William Bronchick is also the author of the highly acclaimed books, “Financing Secrets of a Millionaire Real Estate Investor”,” Wealth Protection Secrets of a Millionaire Real Estate Investor”, “Defensive Real Estate Investing”, “How to Sell a House Fast in a Slow Real Estate Market”, and his latest work, “The Business of Flipping Homes.” William Bronchick is the co-founder and past President of the Colorado Association of Real Estate Investors and the Executive Director and founder of the College of American Real Estate Investors. He is admitted to practice law before the bars of New York and Colorado.

As promised, here is a link to one of my videos on **Negotiating Seller Down Payments**. I hope you find is helpful!! Best of luck on your journey to real estate investing!