Get Real
(estate)

Get Real Podcast Episode: 013

"What Leveraging OPM Really Means"

Hosts: Ron Phillips & Angela Thomas

Welcome to The Get Real Podcast, your high-octane boost and in the trenches tell-it-like-it-is reality therapy for personal, business and real estate investing success with your hosts, power-preneurs Angela and Ron. It's time to *get real*!

Angela: Hey, welcome to the Get Real Podcast. I'm Angela Thomas and I'm here with Ron Phillips. Hey Ron.

Ron: Here we are.

Angela: Hey, so today we are going to talk about leveraging OPM, which stands for other people's money. I know this is a hot topic. We get questions about this all the time, so it should be a pretty fun discussion.

Ron: Yeah, there's a ton of different ways to do it and it's incredibly powerful and you know.

Angela: And we're going to, we're going to get real about it. So first off, we're going to get into the good, bad and ugly like we always do. So first off, Ron, I just, I mean, I kind of want to talk about something I heard recently from a really good friend of mine. She went to a seminar just recently where they, it's this big company and they were teaching people that to get started in real estate, you need to partner with somebody who has a really nice 401k or IRA retirement account, which is usually an older person. So you partner with them and use their retirement account to invest in a property where you purchase the property, and then you also use their money to rehab it.

Angela: So they're teaching people who have never done a rehab and have no experience, you know, leading contractors or you know, getting something done on time. They're teaching them to go borrow money from grandma, have her empty her retirement account and use that money to practice and learn how to become a rehabber basically. I mean, how many ways can that go wrong? I'm floored that they're telling people to do that.

Ron: Well, I am not shocked at all that they would tell people to do. It is very dangerous. So I mean, to get real with everybody, if you are new, the last thing on the planet that you should do, is go and get some old person's money out of their 401k or you know, retirement account or out of their bank account or anybody else for that matter that you, I was going to say that you care about but even if you don't care about them, you shouldn't go practice with other people's money. That is not shat other people's money in his for.

Angela: No, and I forgot to say that this, this company is teaching you and the reason they tell you it's a good thing is you're actually going to help that person increased their account because you're going to, you're going to give them back their money first and then you're going to split the profits. So, Ron, I mean, I could say it, but what is the problem with that plan?

Ron: Well, again, I think I've said this on another episode but a wise man once told me that you should always concern yourself with return of capital before return on your capital, right. And I would never loan my money to a new person to go and do a deal. And I understand the deals and I wouldn't do it.

Angela: And that's why right.

Ron: And there's a real clear reason why. Because they don't know what the hell they're doing. And you know, if you just attended a seminar and now you think you understand what you're doing to go buy a property and renovate it, put it on a retail market and sell it for a profit, you are, you have absolutely smoked a really good strain of something, right? I mean, it's, it's, your high.

Angela: I mean even doing a little, a little project around your house, dealing with one contractor. I mean, it always goes over time and over budget and you're dealing with trying to rehab an entire house without having any of the right connections or you know, knowing how to manage a team or any experience.

Ron: Any experience whatsoever, right.

Angela: Yeah. There are so many things that could go wrong.

Ron: Now next thing is, is you'll get handyman Joe down the street who, um, who does know a thing right about doing construction projects, maybe worked in construction before and they think that they can also go do this without any experience and they'll just go grab some money from somebody down the street. Also bad plan because what they usually don't understand is all of the finances that go behind the construction because they didn't run the construction company. So look, I'm not saying shouldn't go use other people's money. That's not what you were saying either Angela.

Angela: No, no. Just there's the right way and a wrong way to do it.

Ron: But good Lord go get some experience first. I mean for crying out loud, go out there and actually either play with your own money or, and here's the other thing. If you have no money with which to make up the loss for grandma down the street...

Angela: That's so sad.

Ron: You should not be playing with other people's money, right. On a rehab, right. There's a whole host of other ways you can do this and you don't have to go and empty out grantees bank account. So just upfront if you're new, you should not be doing that. And if you are one of the companies out there teaching people to do that, shame on you. You shouldn't be teaching people to do that.

Angela: Now, Ron, just as a reminder, I know you've told this story before, but you talked about, you know, on our first episode how you got started and you did your deal without using your own money your first time, right?

Ron: Yeah, absolutely. But I also didn't use grannies money incidentally, right. No, it was really, I did tell that story. I'll just really quickly tell it again and if you, if you want the full story, you got to go back a few episodes and listen to all of them. But yeah, I found a problem in a house and what I did was I went in, I used an option contract, right. I bought an option and I didn't have any money, okay. I just told people that don't have any money, that they shouldn't go get raid grannies money, right? What I did was I did something really creative. So when you're talking about OPM, you can leverage. So I leveraged this woman's equity, which is her money, right? I leveraged her equity. And I leveraged my brother's ability to fix things because he was the, Joe down the street who, you know, knows a thing or two about fixing stuff.

Ron: So we walked into this house, there's a stain on the ceiling and that's the reason the house wasn't selling, right? They hadn't fixed it. So all I did was I went in and I said, hey, I'm going to put your house under contract and this option contract, I have 30 days to perform on this option and for the option consideration or for the money that I would pay you for the option, I'm going to fix the ceiling. And so then I went and got my brother who knows a thing or two and I brought him in and we fixed the ceiling. It costs us like a hundred and some odd dollars to fix it and then we sold the house. And so you know, that's a great creative way to use other people's money. Because I used her money and I didn't have to pay anybody to help me fix the ceiling because my brother knew how to do it and he had enough resources to be able to go do it, right. The hundred and whatever it was, and we had to go do it...

Angela: Most of us have at least that much resource, right.

Ron: I didn't have that much resource.

Angela: Oh just your brother did.

Ron: Just my brother did. Once again...

Angela: But that's a great story because that shows, I mean, obviously we believe in using other people's money. We're not trying to dog it, you did it yourself, but you did it the right way. There's good ways to do it and not so good ways, right?

Ron: Yeah. Yeah.

Angela: So that's a great story.

Ron: I mean there's a whole host of ways you can do it. A lot of people think using other people's money means you go get their cash and you use it. But in the, in the scenario that I just talked about are really didn't use, I didn't really use anybody's cash so to speak, but I did use people's money, right? I used the equity and I used and I also used and also leveraged other people's talents as well, which is something that you could do really creatively to get deals.

Ron: That's not really what we're talking about in this whole thing, but I mean, we're going to talk about other people's money, how to use other people's money in very creative ways. But it goes without saying that if you don't have any at all, you shouldn't be stacking up properties for which you can't make the payments if something goes wrong, right.

Angela: Right. And so, yeah, it doesn't mean borrowing grandma's money and it doesn't mean getting some ridiculous loan or putting it on a credit card or you know, having someone else do that for you. So what are some of the good ways that you would do it? You said, you know, option contracts.

Ron: So I mean an option you can do a lease option, which is just an option with a lease attached to it. So it kind of depends on what kind of a deal you're trying to put together. You know, if you're trying to, you're trying to purchase a property you because you're going to rent it out and make the cash flow, you could use a lease option, which gives you the option. All an option is basically what it sounds like. It's, I'm buying the option to buy your house for a determined period of time. So I'm going to pay you something for the right to buy your house at X dollars for the next six months, three years, whatever it is, right. And I am the only person who has the right to buy that house at that price during that timeframe. You can't, nobody can sell it out from underneath me.

Ron: But I can also, I can sell my option to someone else. I can also include a lease with that. So if I want to do a five year lease option, I'm going to have an option to purchase at a set price for five years and I'm going to also have a lease where I'm leasing the property for those five years in addition and that makes it similar but not the same as owner financing because it's not owner financing, it's actually a lease. And then I can also, I can have my lease payment at $500 and I can go lease the property out for $800 and then I can take the cash flow and then hopefully over that five-year term, the property goes up in value. I can then sell my option or I can close on the property and keep it or whatever I want to do.

Angela: Cool. So you mentioned owner financing. Can you, maybe it'd be helpful to go through a few, you know, a few of these different options and when you would use them, you know,

Ron: Sure let's save owner financing for last owner financing is really cool. I love owner financing. I've used it a bunch of times. I'm actually going through a course right now from buddy of mine, who was, if not very possibly, the owner financing expert in the country, his name's Eddie Speed. You guys should go look him up he's a stud. Just to review and I'm getting some new ideas from him too that I hadn't thought about. Also some new angles of ways to look at owner finance was really cool, use it a lot during my career and, anyway, that'll be fun to talk about. But let's talk about private money.

Ron: So private money is granny down the street. Okay. Or your buddy or, and, or there's also just their private money institutions that you can go to as well when they're, they're called hard money lenders, right. But private money doesn't have the same rules as a regular bank. So Angela, when you went to go buy your house, there's all these regulations and things like that.

Angela: All the fun paperwork you get.

Ron: Oh yeah. Well so private money doesn't have any of those rules. So granny down the street, she may have some rules that she wants to impose upon that money. They're going to be different than, than the banking regulations and using private money there's a ton of different places you can get that. Granny down the street, you can do syndication deals, private placement memorandums. You can raise money from people in your sphere of influence. Folks with retirement accounts sector, self directed IRA's that want, they want a good return on their money. So many different ways that you can get that money, right.

Ron: Usually, usually on private money there's some kind of points you pay up front and then there's a higher, much higher interest rate that you pay and it's usually short term money. Not always, but it's usually short term money. And it's for that example you were talking about earlier, Angela, where if somebody wants to go rehab the house, you know, that they just found, okay.

Angela: Which is great if you, if you know how to rehab a house and if you can get it done within that time period, then you both end up making money and it's a great deal, right?

Ron: So of the institutional lenders who lend to people who are new, there are fewer of them, but some of them do. And they impose, you know, quite a little bit of, I mean their rules are different for new people than they are for seasoned folks. But if you're a new person, I used private money and I used institutions when I first started out because they were the ones who would lend me the money. I'm pretty sure I paid between %15 and 18% interest on the money. It was really expensive. But it allowed me to get my foot in the door and I just figured it into my deals and it became a cost of doing business. Um, so...

Angela: And then you can get cheaper and cheaper money as you get more experience.

Ron: Right. I mean, I got to lower that down with the exact same company and you know, over time when they, when I was performing, which is what you need to do. So, okay, cool. So that's private money. Let's not spend a ton more time on private money, but it's, it's there. It's all over the place right now. So you can go get it anywhere.

Ron: You can also buy property subject to the existing mortgage, which is another one of the favorite ones of mine. I've done this in the past and it is really cool. And really what it means is Angela, let's say you're selling your house and it's because you got a job move. You know, you and your husband are moving to California. I was going to see Texas, but I know you wouldn't go there. So California. But your house isn't selling.

Ron: You're going to go there and you got to rent something and your going to have two payments and it's going to suck and now you're in a bind. Well, I come along and I say, Angela, here's what I'll do. I'll make all of your payments for you, all I need you to do is we'll put, we'll put this property into a trust deed, the property into a trust, and then you assign the beneficial interest of your property over to me, I'll make the payments on it. Probably going to take me a couple of years to get somebody in there who can actually afford to buy it and take you off of the mortgage but in the meantime, you won't have to make two payments now.

Ron: Somebody listening to this right now is saying what I said when I first heard it, which is what kind of moron will deed your their house and keep the mortgage.

Angela: Right. I know. And you get all the benefits but my name's on the mortgage. Yeah. That doesn't, I mean, unless you can't afford to pay the two payments that, I mean, that doesn't make sense, so.

Ron: That was the exact scenario upon which I used to buy my first subject two deal. They were moving and they could not afford both payments.

Angela: And that happens.

Ron: It was a job change and they also could not sell their property. The reason they couldn't sell their properties because they bought it last year, it hadn't appreciated it enough. They couldn't come to the closing table with cash and so I was the best solution for them. And it took me a year, I put a lease option tenant in place, and then I made cash flow all that year. And then I also cashed out the equity piece at the end, and then I took them out of the note, took me a year to do that. And so was I using other people's money? Yes, but I was in a creative financing way. That's a safer way for me to do it. I also had some money set aside so that if people moved out, I could make the repairs and things like that. So if you have $0 and you do that and somebody moves out of the house and you can't repair it and you can't get another tenant in there, you have to make that payment with, with nobody making the payment.

Angela: You're saddling yourself to debt with no way out, yeah.

Ron: So don't do that, right. I did some in the beginning I did a bunch of, I did a bunch of deals that created cash for me that I could set aside so that I could do these kinds of deals.

Angela: So just out of curiosity real quick, I know we don't have a lot of time. How did you find that I mean, that person, that specific house where somebody's, you know, needed you to do that, like a subject two deal?

Ron: I think this is a great place, so the people who are listening who have marketing programs already going, so I was out there marketing to get a really distressed homes that I could rehab. These people called me because they had a problem. Well, when I went to look at the house, the house was not distressed at all. It was actually, really it was the nicest house in that time period in my business that I ever bought. It was, it was already done but they owe too much on it. And when they called me, I was like, well, I can't pay cash. Well you need to come take a look at it. And so I did I went and came and took a look at it. And when I, when I got done, uh, and we started talking about money, I said, this is what I can do.

Angela: Makes sense, cool.

Ron: And it took them a couple of days to come to terms with that. That's what they wanted to do. But they, but they did come to terms with it. So if you are marketing and you're leaving those kinds of deals on the table, because there's not enough equity spread in them, you are losing money big time because people will do that when they're in a situation. And I helped them. So it's not like I took advantage of them.

Angela: No they needed it, it was their only option, yeah.

Ron: I mean they were really, really in a tight spot. And so I helped them and I got paid and I also helped another person fix their credit so that they could actually move into a really nice house and so it was a win, win, win. Everybody won in that situation.

Angela: Cool. Alright moving on.

Ron: Yeah, so let's talk about, that kind of moves us into owner financing and you know, it's, this is going to be really, really cool. So doing, doing what I just talked about and doing owner financing deals, creative real estate deals, it's going to be really big moving forward for a couple of reasons. A lot of people are going to owe when the market starts to flatten out or starts to go down just a little bit, people are going to owe more on their property, then they can self, because they have to pay realtor fees, 6%. Usually they got closing costs and some fees and things are going to have to pay, which is another usually 2%. So you take 8% off the price of their home they can't do it. Otherwise they'd have to come to the closing table with money.

Ron: But they all, I mean almost all of these people are going to have ridiculous loans because we've just had the lowest loan rates ever and they're all 30 year fixed mortgages, right? So we've got super low rates and when you go in, you talk to these people, A, you could do a subject two the existing mortgage. But let's say you're talking to somebody who's owned their house for a long, long time. They want to sell it and they don't owe anything on it or they just a very little on it or whatever.

Ron: Well then you could do owner financing. Those people can, can actually finance you their home. And this is where, and even on the subject two deals, you can create whatever deal you want I mean, sky's the limit . Literally you’re only hampered by your own creativity. Now, something that I had never actually thought of it as an angle that I've never thought of before, but I mean, I knew that you could, I've just, I had that subject two deal that I talked about I mean, I did that back in the early two thousands, so it's long time ago. And I knew that I could create deals but I had never thought about it from this angle. So check this out.

Ron: Let's say you have a mortgage and any of you that have like a financial calculator or whatever, you can get it out and you can play along. But let's say you have a mortgage, right. And your mortgage is $100,000, right? So let's say that's what's owed left on the property and the mortgage is at 5%, okay? That puts our payment at $554 bucks just call it $550. Okay. Just to make the math easy. So we have a $550 payment. Now I know as I'm talking to these people, I know I can rent that property for $900 to a $1,000 bucks easily. So it's going to cash flow even after all of the vacancies and everything like that, I know this thing's going to cash flow really, really well, but they can't sell it to me. They want to sell it to me for $115,000. Well, I want to buy at a deep discount for sure. So, you know, because I want cash in my deals when I buy them, but if I can get really, really good terms, then I can create a really good deal where there wasn't a good deal.

Ron: And so think about it this way. If I lower the interest rate that I'm going to pay, let's say they, they don't have a mortgage on it at all, but I want to create a mortgage and I don't want to pay any more than $550 or %500 right? And they want a $120,000 and you know, they're just kind of stuck. Well, if I figure $120,000 on 5%, that doesn't work for my payment, right? $120,000 now I'm up to $670 that eats $170 of my cash flow and I just don't want to do that, but these people are stuck, they're stuck on $120,000. So what if I go back in there and instead I back into this, I say, okay, cool I'll give you a $120,000 for your house, but I'm going to need you to finance it to me and I want my payment to be $500 bucks.

Ron: So, let's see my interest rate on what could I do if I wanted my payment to be $500 bucks? Let's just see what I could pay for the house. If my interest rate, we're 2% everything's the same, but I want my payment to be $500 at 2%. That means I could pay $130,000 for that house. They only want $120,000, right. So my terms, just for moving the interest rate, which is only one of the levers, just by moving the interest rate it significantly changes what I could pay for the house, right? Now obviously I don't want to pay overpay for the house, but if $120,000 is actually a fair deal and they're willing to give me really good terms, I can make this thing still really, really attractive long term, okay.

Ron: Because I can go in and I can say I want a $500 payment I'll give you $120,000 purchase price and I want it, I want to amortize it over 30 years, but at one and a half percent interest and then I'll put a 10 year balloon payment on it. Which means in 10 years it's due, I'll have to pay you the full amount in 10 years. But during those 10 years, property value's going to go up, I can sell it to somebody else, I can just take the cash flow and refinance it later. So many different things I can do with that property and it's going to cash flow like crazy if I can get the right terms, I can even go in and I can suggest to them, hey, look I'm going to do only principal payments. And what that means is I'm not paying you any interest at all. It was just an interesting way of saying it, right? So I'm going to pay you, I'm going to pay your principal payments.

Angela: It sounds nicer if you say, I'm going to pay your principal.

Ron: Right, because everybody wants principal. But I could also go in there and I can say I'm going to do interest only payments, I'm not going to pay any. I mean there's so many different things that you can do to structure a deal on owner financing because there is, there aren't very many rules there. It's not like you're going to a bank because if you go to a bank and you say, well I'm going to put no money down and I'm going to, I want 2% interest and I want you to finance it over 30 years and I want you to give me the first five years interest only.

Angela: I mean I tried that on my personal residence...

Ron: And how did that go?

Angela: He laughed me right out of there man. I had to go to a different bank.

Ron: But this is crazy and it works really well. So I'm negotiating a deal right now on an apartment complex for no money down because the guy he needs too much out of it and he's stuck on his price. And I went back to him and I said, well, would you consider owner financing it? Yes. So now I'm just putting together, I'm putting it under the terms that work for me and I'm going to go back to him and since he's stuck on his price, he doesn't need the money right now. He just doesn't want to it for less than X, okay. If he gives me fantastic terms, I can make a screaming deal out of that and I don't have to qualify at a bank. I don't have to put money down. It's a no brainer and it's in an opportunity zone, which is another thing we were supposed to talk about.

Angela: We're going to talk about that late, right.

Ron: I can make a terrific deal out of this just by getting creative with all the different levers that I can pull with owner financing, right.

Angela: That's really cool. That's powerful.

Ron: So whoever it was that was teaching the seminar. Hopefully they told you some really cool things that you could do with, with other people's money before they told you to go and raid grannies vault.

Angela: The people that told me about it, that's all they remembered. So I hope they did.

Ron: Because there's so many other ways that you can use other people's money. And then once you, once you're seasoned, oh my gosh. I mean, using other people's money you can do some really cool creative things. Speaking of apartment complexes, Angela, you can go raise funds and give people a really solid return on their money, but you can go buy way more property than you could on your own and you're basically partnering with these people. And it' another win win for everybody that's involved.

Angela: Yeah. It's really cool. We'll have to do a little bit more on that too, the bigger deals because that's really fun, it's fun to talk about. So I think it's worth, I know we're, you know, kind of over time here, but I think it's worth mentioning too that our favorite way of investing just on, on rental properties is also leveraging other people's money. I mean, yeah, you do come to the table with the down payment, but you have other people that are paying down your mortgage, right?

Ron: Absolutely. And in every situation when you have rental property, you're using other people's money. Tenant's money, your using the bank's money.

Angela: Exactly. The banks and the tenants.

Ron: Yeah, everybody's money. And that's the reason it's so powerful. It's because you're leveraging other people's money. Just not necessarily grannies when you're brand new.

Angela: We just had to bring that up again.

Ron: Have we beat that? Have we beat that down yet?

Angela: I don't know it's still funny to me. I think, yeah, we've probably mentioned it enough. I think everyone got it. We don't agree with using grannies money.

Ron: I don't know, Angela used to teach when we used to teach classes. Do you remember at the classes, I would tell people up front how we made money and then invariably at the end someone would say, yeah, but how do you make your money? They still didn't get it, so I don't know, man. Maybe people didn't get it yet, maybe we should be really direct. Don't go use granny's money if your a newbie please, for the love please don't do that.

Angela: Alright. I love it. Okay.

Ron: If granny's listening, don't give someone your money.

Angela: Don't give your money out.

Ron: Don't give your money out to the newbie.

Angela: No. Cool. Alright, well I think that's all we got on that for right now. If you have anything, you know, if there's anything, any subject we talked about that you want more info on, or if it made you think of something else you'd like us to do on a future episode, please let us know. You can contact us on, GetRealEstateSuccess.com. You can also subscribe there. So please do and let us know what you think. Thanks for listening. Thanks, Ron.

Ron: Awesome. See ya.

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