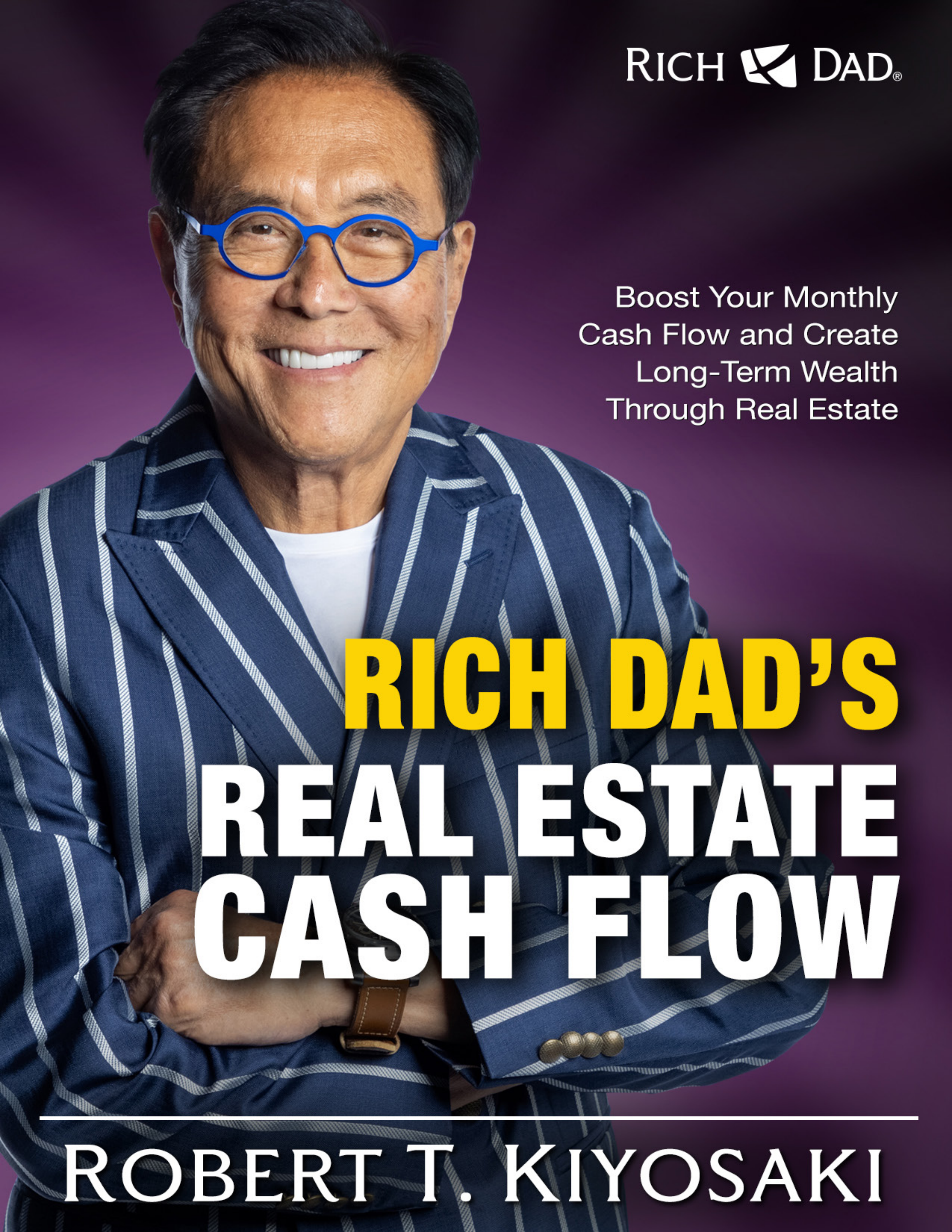

RICH DAD®

Boost Your Monthly Cash Flow and Create Long-Term Wealth Through Real Estate

RICH DAD'S REAL ESTATE CASH FLOW

ROBERT T. KIYOSAKI

RICH DAD'S REAL ESTATE CASH FLOW

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CHAPTER 1:

Rich Dad vs. Poor Dad and the Winner is…the Tsunami

In 1960, the most powerful earthquake in recorded history struck southwest Chile. It was a magnitude 9.5 and could be felt for over 600 miles of Chilean coastline.

Fifteen hours later and almost 7000 miles away, this record-setting earthquake caused a massive tsunami that bombarded the island of Hawaii.

The Hilo Bay area where my family lived was hit particularly hard. The 35-foot wave destroyed more than 500 homes and businesses, and damages topped $75,000,000.

No one expected or prepared for this - while this was not the first time a tsunami struck our town of Hilo, you can never truly prepare for a disaster of this significance. Many people lost their homes, their businesses and livelihoods. And sadly, many people, including a few of my classmates, lost their lives.

This tsunami was devastating to many, but a few people found a way to come back even stronger than before.

One of those people was my rich dad.

When I wrote my book, Rich Dad Poor Dad in 1997, I told the story of the two men in my life who approached money, wealth, and finances from two very different perspectives.

One was my poor dad, my real father, who valued academics over money. He valued education so much he completed four years of undergrad studies in just two years, then continued on to earn his Ph.D. After that, he then went to Stanford, University of Chicago, and Northwestern to complete more advanced studies - and he did it all on full financial scholarships.

Poor dad really drove home the importance of education. In our home, getting a good education wasn't just an assumption; it was a demand.

Even though he was highly educated, poor dad always struggled financially. He often said things like, "Money doesn't matter", and "I'm not interested in things like money." Although he held an important job in the government, he always found it hard to make ends meet and didn't really ever find true success.

The other was my rich dad. Now, my rich dad wasn't actually a biological dad or family member by blood. He was actually my best friend's father. Rich dad taught me nearly everything I know now about money, wealth, and finances. He gave me a financial education that no college in the world could ever duplicate. Even though he never even went to high school, he understood how to make money, keep money, and grow money. He taught me I shouldn't work for money; rather, I should make my money work for me.

Don't misunderstand - my highly-educated (but poor) dad worked hard, too. He did everything he could to rise through the ranks at his jobs, but he never got to the point where he could relax or experience true wealth.

One dad struggled to save a few dollars. The other created investments. One dad taught me how to write an impressive resume so I could find a good job. The other taught me how to write strong business and financial plans so I could create jobs.

Rich dad wasn't born rich. He wasn't highly educated. Instead, he became wealthy through smart, steady investments - many of which were in real estate.

Rich dad knew that nine out of ten times, investments do not make it. Once he realized that nine out of ten don't make it, he knew he needed to be prepared to lose at least nine times.

And in the beginning, he lost big time to... a tidal wave.

The Tsunami

Rich dad's first apartment complex in Hawaii was just one of the many businesses wiped out in the tsunami.

You see, my rich dad built those apartments in a Flood Zone.

According to FEMA, a flood zone is any area or property that's next to a body of water. And since most insurance policies don't cover floods, if you build in a flood zone, you're playing a dangerous game.

Rich dad found this out the hard way.

The tsunami won.

Because when his apartment complex was wiped out, my poor dad said no to helping my rich dad rebuild.

At the time, my poor dad represented the city and state governments. His job was to condemn the lands that lay in the path of tsunamis. As I said, it was not the first time a tsunami had hit the town of Hilo.

The problem was that some of the land he was condemning belonged to rich dad.

Poor dad thought rich dad should give the city and state his land for free. Rich dad wanted a good price for his land.

Neither was a man who was accustomed to giving up.

Bottom line - they were at odds.

So never being one to let a good problem go to waste, my rich dad sued the government and even ended up selling the flood zone property to the Hawaiian government.

This solved two problems for him:

1. He made his money back on the "flood zone" property
2. He now had a sizable down payment to use for another real estate venture

So, what'd he do?

He took the money from the sale and built a hotel in Waikiki.

The hotel in Waikiki was fully paid for, and once built, it brought in a substantial amount of money on autopilot. Once it was built, my rich dad owed nothing on it, and enjoyed a regular (and large) payday for doing nothing.

Now, this was a big win for rich dad, and a big win for Hawaii. At that time, there were plenty of luxury accommodations available, but very little in the way of affordable places. Rich dad noticed this and built his hotel to serve not just tourists but also locals. The impact on the community was instant and this hotel - again, the hotel he wouldn't even have if not for that tsunami - became part of his legacy.

Learn By Playing A Child's Game

I've written extensively about the incredible financial education I got from playing the board game Monopoly®. You see, when I was young, rich dad taught me to be a real estate investor by playing Monopoly.

Meanwhile, my poor dad - the school teacher - always told me "Put that silly monopoly game away. Go back to school, get good grades, and get a good job".

Rich dad would tell me "Monopoly is the formula for great wealth."

Most of us know how to play the game, but in case you haven't played, in Monopoly, you have to build four houses on a property before you can add one red hotel. Once you add in that hotel, you're unstoppable.

In the game of Monopoly and in life, the more houses and hotels you own, the better. The more properties you own, the more you profit. That's how you win the game.

Now, most people can't just purchase a big red hotel outright.

They are not cheap! And what's more is most people don't have the financial education to do so.

But, most people (if they plan correctly) can purchase a single-family residential home. And with the right plan and maybe some help, they can then purchase another, and another, and another.

After a while, those 4 houses can be sold for a profit and you can take that profit and reinvest it into something much more lucrative - like a big red hotel.

Once I understood how this worked, I finally began to understand what I now call "The Theory of Infinite Returns."

Is It A "Good Investment" Or Is It Chump Change?

Ask any financial advisor what a good rate of return is on an investment and they'll usually tell you between 8-12%.

This can easily be achieved with simple investments in stocks, bonds, and mutual funds, a 401k and a Roth IRA.

But there are big issues you need to be aware of with stocks, bonds, and IRAs.

They can pay off slowly over time, but also in an instant - you can lose everything.

This is because stock prices have zero connection to reality and the payout is minimal compared to real estate.

This is because real estate is a hard asset that will always be valuable as long as people need places to live. Think of it this way - if the stock market crashes or we ever enter another Great Depression, people still need roofs over their heads.

So, while others call an 8%-12% ROI a "good investment," ...

...I call it chump change.

And here's why - instead of getting an 8%-12% ROI from investing (which is better than parking your money in savings and having it do NOTHING for you), you can get an infinite return with real estate.

This means that you can literally make money out of nothing if you have a high financial IQ and a game plan.

Please understand - I'm not talking about getting *infinite sums of money* in return for doing nothing.

Instead, I am about to explain how you can put none - and I do mean **zero dollars** - of your own money into and deal and still make a cash return.

A Tsunami is Coming - Will You Be Ready?

You have a choice to make. Do you keep doing what you have been doing, working 9 to 5 and playing by the conventional rules of staying put until it's time to retire, or, do you commit to becoming financially literate, doing the work, and carving out a new life for you and your loved ones?

These are your options. Because real estate is a great investment that does well no matter what the economy is doing. And I assure you - another tsunami is coming - a financial one. This is one that can wipe out the stock market, your 401k, and any other paper assets you may have.

This is why I love real estate.

It's not going anywhere.

But still, I hear this all the time - "Robert, it will NEVER happen, The US Economy could never crash!"

Well, tell that to:

- Those who lost it all in the Crash of 1929...
- The people who lost their jobs in 2008...
- Or the families who lost their HOMES in that same year...

And I could go on…

The last crash of 2008 destroyed lives, families, businesses, homes, relationships…

8.8 MILLION jobs were lost. Mass layoffs occurred and unemployment DOUBLED almost overnight.

2.6 MILLION homes were foreclosed on - with hundreds of thousands of homes *still sitting empty YEARS later*

Another 5 MILLION people had to seek loan modifications - meaning all in all, almost 8 MILLION families couldn't meet their original loan obligations. (And that's not even counting the people who had to sell at a loss in a hurry.)

Because of this, housing values PLUMMETED - making an unstable situation even worse.

The US Treasury pumped hundreds of billions of dollars - $439.6 BILLION, in fact - back into bailing out failing companies, but it didn't help as much as everyone hoped.

The economy remained in free fall for some time.

It took years to recover from this crisis - and it's going to happen again soon - a new tsunami.

My fear is that this time it'll be worse than the others...

Bitcoin can't stop it. Gold can't stop it. Not even the President of the United States can stop it.

It's long overdue.

The fact is the US economy will collapse.

And the ones who are waiting on the government, or anyone else to save them or shield them will lose big time. Good people will suffer after it hits. Families, lives, businesses, retirement accounts, all will be hit hard.

Is that scary?

Well, yes.

Is it true?

I'm confident that it is.

Why not get ahead of it, be prepared, and set yourself up for success instead? Heck, during a crash or recession, real estate investors make even more than they do when the economy is strong! Good or bad, real estate has always withstood the test of time.

The Last Time Disaster Struck Overnight

In 2008, U.S. home prices were driven unrealistically high by low-interest rates and absurd lending practices that gave houses to people who couldn't afford them.

These were people with:

1. Not enough income...
2. No credit...
3. Even worse - bad credit...

The whole thing was a fraud, and everyone looked the other way because everyone was getting rich off of it - the lenders, the banks, the loan officers, the title companies, and of course - the borrowers who took the house keys.

But…

As credit markets began to freeze and banks started to pull back, things started to quickly unravel.

Lehman Brothers crashed in September 2008.

They were in business for 167 years (and the 4th largest investment bank in the U.S.) and seemingly overnight…

...they went under.

Gone.

Then the others followed:

- JP Morgan acquired Washington Mutual...
- Bank of America took over Countrywide & Merrill Lynch...
- Wells Fargo nabbed up Wachovia...
- And Mitsubishi even bought 21% of Morgan Stanley!

It was a total nightmare.

Millions of people lost their homes, their jobs, and their nest eggs. Now some people predicted this, but everyone was too busy counting money to notice, or, frankly, to even give a damn.

Fast forward to 2018.

Some people are predicting a similar crash to hit in the coming months or years.

"A $68 trillion 'Biblical' collapse is poised to wipe out millions of Americans." ~Jim Rogers

A tsunami is right around the corner.

What can you do to prepare for it?

To protect your loved ones?

To be ready not IF, but WHEN it hits?

Well, contrary to popular belief, there's A LOT you can do. And my suggestion is to get started by investing in something that can't disappear overnight, is always in demand, and will make you mountains of cash in any economy. That thing? Real estate.

Real estate is the *one thing* that can make your "dream life" (that seems so far off right now as your reading this) an actual tangible reality for you.

All you need to do is follow the blueprint I'm about to share.

CHAPTER 2:

Why Real Estate Makes Everything Better

Here are some reasons real estate beats just about any other method of investing - hands down.

Your Pedigree Doesn't Matter

At the age of 15, I did not pass the subject of English. I received a failing mark because my spelling was horrible and I could not write— or I should say my English teacher did not like what I wrote about.

That meant I had to repeat my sophomore year.

The emotional pain and embarrassment came from many fronts. First of all, my dad was the head of education. He was the superintendent of education for the island of Hawaii and in charge of over 40 schools. There was much snickering and laughter throughout the halls of education as word spread that the boss's son was an academic failure.

Second, failing meant I would have to join my younger sister's class. In other words, she was moving forward and I was moving backward.

Third, it meant I would not receive my athletic letter for playing varsity football, the sport I had played my heart out for. The day I received my report card and saw the F, I went behind the building that housed the chemistry lab to be alone. I sat on the cold concrete slab and began to cry deeply. I had been expecting this F for a few months now, but seeing it on paper brought out all the emotions suddenly and uncontrollably. I sat alone behind the lab building for over an hour.

My best friend, Mike, rich dad's son, had also received an F. It was not good that he had also failed, but it was good that at least I had some company in this time of misery.

I waved to him as he headed across the campus to catch his ride home, but all he did was shake his head as he kept walking to the waiting car.

That evening, I told my mom and dad I had failed English. Even worse, the educational system had a policy requiring a student failing either English or social studies to repeat the entire year.

My dad was very familiar with the policy, for he was the one who enforced it. While they had expected the news, the confirmation of my failing was still a difficult reality. My dad sat quietly and nodded, his face expressionless. My mom, on the other hand, was having a much harder time with the news. I could see the emotions showing on her face, emotions that went from sadness to anger. Turning to my dad, she said, "What is going to happen now? Will he be held back a year?" All my dad said was, "That is the policy. But before I make any decision, I will look into the matter."

For the next few days, my dad did look into the matter. He discovered that out of my class of 32 students, the teacher had failed 15 of us. He had given D's to eight others. One student had an A, four had B's, and the rest had C's.

Seeing such a high failure rate, my dad stepped in, not as my father, but as the superintendent of education. His first step was to order the principal of the school to open a formal investigation. The investigation began by interviewing many of the students in the class. The investigation ended with the teacher being transferred to another school and a special summer school class being offered to students who wanted an opportunity to improve their grades. I spent three weeks of my summer working my way up to a D so I would be able to move on to the eleventh grade with the rest of my class.

This period was traumatic for me. Not only did I have a failing grade, but I had to attend summer school in order to make up the failing grade so I could go on with the rest of my class. I hated summer school. The subject was boring and the room was hot and humid. It was hard to keep my attention on the subject of English.

My mind often drifted as I gazed out the window, past the coconut trees and out to the ocean where my friends were surfing. To make things worse, many of my surfing friends would snicker, laugh, and call us "the dummies" whenever we ran into them.

When the four-hour class was over, Mike and I would go across town to his dad's office and do whatever he wanted us to do for a few hours. One day, while waiting for rich dad, Mike and I were discussing the impact poor grades would have on our futures. Failing and being called "dummies" were very traumatic for us.

"Our friends are laughing because they have better grades than we have and they will get into better colleges than we can," said Mike.

"I've heard that too," I replied. "Do you think we've failed and messed up our lives?"

Rich Dad's Secret

Rich dad was very aware of our academic failure. His son's F in English disturbed him. He was grateful that my dad intervened and set up a summer-school program for us to make up our failing grades.

Both dads were looking on the bright side of things, and both had lessons that we could gain from this experience, although their lessons were different. Up to this point, rich dad had not said very much. I believe he was just watching the two of us to see how we would respond to our situation. Now that he had overheard what we were thinking and feeling about our academic setback, it was time for him to comment.

Taking a seat in the room, rich dad said, "Good grades are important. How well you do in school is important. How much you learn and how smart you are is also important. But once you leave school, good grades aren't that important."

When I heard him say that, I pushed back in my seat. In my family, a family where almost everyone was employed by the school system from my dad to his brothers and sisters, to say that grades were not important was nearly sacrilegious.

"Those grades will go with us for the rest of our lives," I replied with shock and a slight whine.

Rich dad shook his head and then leaned over, saying sternly, "Look, Mike and Robert, I will tell you both a big secret." Rich dad paused to make sure we were listening attentively.

Then he said, "My banker has never asked me for my report card."

That comment startled me. For months now, Mike and I had been worrying about our grades. In school, grades are everything. My parents, my relatives, and our friends thought good grades were everything. Now rich dad's words were jolting me out of my chain of thinking, the chain of thought that was saying my life was ruined because of bad grades.

"What are you saying?" I responded, not fully understanding where he was going with this statement.

"You heard me," rich dad said, also rocking back in his chair. He knew we had heard him, and he was now letting his statement set in.

"Your banker has never asked you for your report card?" I repeated quietly. "Are you saying grades aren't important?"

"Did I say that?" rich dad asked abruptly. "Did I say grades aren't important?"

"No," I replied sheepishly. "You did not say that."

"So what did I say?" he asked.

"You said, 'My banker has never asked me for my report card,'" I replied. It was a difficult thing for me to say because in my family of educators, good grades, test scores, and a good report card meant everything.

"When I go to see my banker," rich dad began again, "he does not say, 'Show me your grades.'"

Rich dad asked again, "Does my banker ask, 'Were you a straight-A student?' Does he ask me where I went to college? Does he say, 'Oh, you have a big fancy degree. Let me lend you a million dollars.' Does he say things like that?"

"I don't think so," said Mike. "At least he has never asked you for your report card when I was with you in his office. And I know he does not lend you money based on where you went to college - you didn't even finish high school!"

"So what does he ask for?" asked rich dad.

"He asks you for your financial statements," Mike replied quietly.

"He always asks for your updated financial statements. He wants to see your profit-and-loss statements and balance sheets."

Bankers Don't Care About Your Education

Rich dad continued. "Bankers always ask for a financial statement. Bankers ask everyone for their financial statements. Bankers don't care if you are rich or poor, educated or uneducated. Regardless of what you are, they want to see your financial statement. Why do you think bankers do that?"

Mike and I shook our heads silently and waited for the answer. "I've never really thought about it," Mike said finally. "Will you tell us?"

"Because your financial statement is your report card once you leave school," rich dad said in a strong, low voice. "The problem is, most people leave school and have no idea what a financial statement is."

"My financial statement is my report card when I leave school?" I asked suspiciously. "You mean it's the report card for grownups?"

Rich dad nodded. "It is a report card for grownups. Again, the problem is, most grownups do not really know what a financial statement is."

"Is it the only report card adults have?" I asked. "Are there other report cards?"

"In life, there are many different types of report cards. A person's financial statement is an important one."

"So a person could have straight A's on their report card in school and have F's on their financial statement in life?" I asked. "Is that what you are saying?"

Rich dad nodded, "Yes, and vice versa. Happens all the time."

Even Beginners Can Do It

People worry that you have to have a wealth of knowledge in order to succeed in real estate.

They think you must have a fantastic college education, or to have it all figured out before you ever get started.

Nothing could be further from the truth.

Yet these myths hold people back every single day.

People often delude themselves into thinking they have to already be experts in a field in order to be successful, whether it's real estate or investing or dry cleaning!

That is not the case.

As three time Grand-Slam tennis pro Arthur Ashe said, " Success is a journey, not a destination." And he couldn't be more right. All successful people start at the same place. One day they wake up, they pour a cup of coffee, they set their minds to a task - and they begin.

Only by beginning and by continuing day after day do we ever become experts.

We gain expertise through experience and we learn through failure, and truth be told, many of the most wealthy and successful people I know never went to college.

College - the Biggest Scam of Our Time?

If you want to be rich, you cannot count on school to get you there. Think of just how many college-educated broke people you know.

If the business world did what most colleges do, they'd all end up in jail.

I'm not kidding.

For the first time ever, in 2018, more 18 to 34-year-olds live at home with their parents than in any other arrangement. In fact, more than a third of graduating college seniors planning to live at home at least a year or more after they finish college.

This is more than a problem - it's an epidemic.

Because now college grads move back with mom and dad, they owe tens of thousands in student loans, and many of them can't find decent jobs even though they have a shiny new degree.

There's no way to escape this debt. You can't default on student loans. And you have zero guarantee, refund, or money-back policy if you find out that your degree is really worth nothing in the real world.

So the colleges get your money, enslave you to this bad debt, and produce a "product" (which is the college grad who can't get a job and isn't prepared for the real world). And the sickening part is that there aren't any repercussions or consequences for doing it.

Because college is not "real life" and the product isn't results based. They can give you a piece of paper and take $60,000 from you without batting an eye. But are you ready to take on the world? Can you get a job? Did you actually learn anything practical in the business course?

Probably not.

If your college professor in the MBA program knew anything about business, they'd be running one, not teaching teenagers how to do it in a classroom. So don't buy into the lie. Colleges don't care if you can't get a job or function in the real world after you graduate.

All they care about is taking your money and building their new stadium.

The entire system is a financial scam that has the colleges laughing all the way to the bank.

So to answer the question - do you need to be "smart" to succeed in real estate investing? Well, if you're talking about classroom smart or having a degree, the answer is no.

You do not need a degree.

And unless you want to be a scientist, doctor, lawyer, or something else that requires a degree, all college will do is hurt you financially, not help you.

We're not in the 1970's anymore. Information is available to everyone now. You can learn the basics of just about subject for free (or very cheap) these days. With the technology open to you right now as you're reading this, you can learn at accelerated rates that people only dreamed of just twenty years ago.

But what have the colleges done?

They haven't become cheaper or even better, <u>they've become more expensive and irrelevant.</u> The product isn't necessary and doesn't produce results, but people everywhere are lining up to buy it.

This is the lie my poor dad believed - that a college education and hard work are all you need to succeed. Well, he was poor for a reason. And as I write this, there are thousands of college graduates working jobs that require no college degree only making thirty thousand dollars a year.

Trust me - there's a better way.

You can make good money and have real freedom in real estate. All you need is a ***financial education.***

Rather than spending years of your life and tens of thousands of dollars… You can get this kind of education from a mentor with success in real-world experience. If you want success in real estate, you need to start networking with people in that world. Ask around and talk to people. Find out who is doing well and then go after them.

Don't try to find an easy mentor or a gentle mentor. It won't do you any good. My first mentor was my rich dad. He was a tough mentor but I'm better because of it.

My rich dad made me work for weeks with no pay just to teach me a lesson. He told me, "Most people have a price. And they have a price because of human emotions named fear and greed. First, the fear of being without money motivates us to work hard, and then once we get that paycheck, greed or desire starts us thinking about all the wonderful things money can buy. The pattern is then set."

"What pattern?" I asked.

"The pattern of get up, go to work, pay bills; get up, go to work, pay bills. People's lives are forever controlled by two emotions: fear and greed. Offer them more money and they continue the cycle by increasing their spending. This is what I call the Rat Race."

"There is another way?" Mike asked.

"Yes," said rich dad. "But only a few people find it. The moment you see one opportunity, you'll see them for the rest of your life. The moment you do that, I'll teach you something else. Learn this, and you'll avoid one of life's biggest traps."

Rich dad's lessons were sometimes painful, but always valuable. He taught me things like how little control

You have as an employee, even over your own money, and how you should work to gain knowledge, not to get money. Obviously, those lessons have stuck with me and now you hear me saying the same things.

The best mentors I've had have been tough. That's because life isn't easy. A good mentor prepares you for the real world in the real world.

So skip the student loans and keep reading.

Your real estate education is just getting started.

Trial & Error

In the early days of my first property management and real estate deals, there was a lot of trial and error. And like every successful entrepreneur, I made my share of mistakes. But for every one mistake I made, I learned ten more lessons and got smarter every day.

In the late 1980s, my wife, Kim, and I began investing in small, single-family homes. When it was time to move on to bigger properties, we purchased a six-unit apartment building in downtown Portland, Oregon.

We paid only $105,000 for the building, and the owner allowed us to put very little down and carried the note. It was in a rough area of Portland, which is why the price was so good, but Kim and I were convinced that the area would clean itself up as Portland grew.

In our panic to get people into the apartment building, we didn't screen potential tenants very well. We didn't run a credit check nor did we require a criminal background check. After the building was filled, our real problems began.

The Friday Night Fights

One night, as Kim and I were finishing dinner, a police officer called and asked one of us to come to the apartments. When I arrived at the building on a warm summer night, I found the tenant from unit No. 4 hanging over the balcony yelling at the tenant who lived below him in unit No. 1.

I approached the officer who had phoned and asked him what the problem was. Chuckling, the young policeman said, "The guy who lives upstairs is a transvestite."

"Oh." That was all I could think to say.

"And the woman who lives below him is a hooker."

"Oh."

The officer continued: "...and the argument is about who is better looking."

Chuckling out loud, I asked, "And who's winning the argument?"

"I can't really tell," said the officer. "The guy upstairs is older, so he's pointing to a picture of himself in full drag when he was younger. And the hooker is strutting her stuff right here on the street, claiming to be younger and hotter. I might have to arrest her for indecent exposure if she takes any more off."

A crowd was gathering, with people looking out their windows or standing in the street watching.

Apparently, it was much more entertaining than anything on TV.

Eventually the argument stopped, and a few months later the prostitute moved on.

Things Heat Up

Shortly thereafter, a young single mom who wanted to move into the building gave me a sob story about how she was down on her luck and couldn't come up with the security deposit.

Feeling sorry for her and her two kids, I bent my own rules and rented her the apartment that had just been vacated by the prostitute.

Three weeks later, the fire department called to say that there was a fire in one of my units. Arriving on the scene, I was informed that the young mother had built a fire on the floor of the apartment to keep warm.

That fire nearly ended my career as a real estate investor. I was so fed up with real estate, tenants, and property management, I almost considered investing in mutual funds.

Did I quit, though? No.

Instead, I remembered what rich dad taught me - investments fail nine times out of ten, so be aware you might not win on the first try. And I went back to the drawing board to study where I'd gone wrong, and what I could do better the next time.

Real Education Comes From Action

I started to see patterns, discover formulas and systems, and developed a network of people I could count on and still do to this day.

Experience in business may make that first walk into an investor's office more comfortable, but that's all it will do.

Because your true power and confidence won't come from your past experience. Not yet anyway.

And it won't come from a college professor, high school coach, or 9-5 job either. It'll come from your first big win. If you follow the blueprint laid out in this book, you'll be able to put together a solid deal that'll be a win-win for everyone involved - a deal so tantalizing and so profitable that everyone will want in on it.

Once you start, you'll meet people, learn your market, see the patterns, and understand the trends. You'll encounter hiccups and problems along the way and even fail a few times, but that will keep it fun and fresh. Before you know it, you'll be wowing people at cocktail parties and barbecues with experiences you've lived rather than just read about.

You won't be quoting me or citing my books. Instead, you'll be talking about the real-life deals you put together and the money you made. And yes, you can get started for next to nothing and even use debt to put together your first deal (and several more after).

Even if you have no money, this can work for you.

But you have to learn the system first.

"Good Debt" Can Be Your Best Friend

In America, debt *is tax-free.*

So you need to get rid of the mindset that is telling you to stay away from debt. Because ***when used properly***, you can become very rich using other people's money. Now, there are two very important words in financial literacy you need to burn into your mind:

Debt and equity.

In simple terms, *equity* is your money and *debt* is other people's money (OPM).

Traditionally, when a person buys a property, they start the process with a *down payment*. In most cases that down payment (the owner's equity) is made with after-tax dollars - meaning that the owner has already paid income tax on the money they used for the down payment.

Now, debt can be very inexpensive money if you know *how to use it to make money*. But it can also be extremely expensive if you use it foolishly to buy liabilities (like that $1,000 iPhone you charged) with a credit card and make only the minimum payments.

That's what I call bad debt and it's the type you should avoid at all costs.

As you're getting ready to start in real estate, you need to realize that all income is taxable. Income is money you receive that's yours to spend as you please with no strings attached. But debt is not income because you have to pay it back.

So when you borrow money for an investment, ***it's really tax-free money.*** And this is what makes debt less expensive than equity. Again, equity is your money that's already been taxed. So even if you have a 5-6% interest rate, the debt is far cheaper than if you had to use equity on which you paid 40% tax.

The idea that you need to have a large lump sum of money to invest in real estate is the wrong one. Most people think it's like saving for their first home or that it's something they can only do once they have made their fortune elsewhere.

But both of these ideas couldn't be further from the truth.

You don't need hundreds of thousands of dollars in the bank to invest in real estate and you certainly don't need millions.

All you need is a good real estate deal that makes sense. One that has profit potential and is based on solid financials. This is the type of deal you'll know how to put together when you're finished reading this book.

My First Real Estate Deal

My first real estate deal came in 1973 when I returned to Hawaii from Vietnam. My poor dad suggested I go to graduate school to get my MBA because, well, that's how most people thought back then (and still do today). But, my rich dad suggested that I learned how to invest in real estate.

The difference?

1. My poor dad was encouraging me to become a high-paid employee
2. My rich dad was encouraging me to become a professional investor

Which one sounds more appealing to you?!

So, while watching television one day, an infomercial came on advertising a free seminar on investing in real estate. I attended the free seminar, liked what I heard, and invested $385 for a three-day course.

Now $385 was a lot of money at the time because I was still in the Marine Corps and not making much money.

But if my rich dad said that was where the money was, I was going all in. And even then I understood that those who invested in themselves were the ones who would end up becoming wealthy (not the employees).

So, I jumped in. The three-day program was great, and the instructor was a rich, experienced, and successful investor who loved to teach.

I learned a lot from him and at the end of the program, he gave me some of the best advice I have ever received. He said:

"Your education begins when you leave the class."

And he meant it.

His assignment was for all of us to get together in groups of three to five students to look at and write evaluations on 100 properties that were for sale. He gave us 90 days to complete the assignment and didn't want us to buy or invest any money (for at least 90 days).

Initially, there were five people in my group.

By the first meeting, we were down to three or four. By the end of the 90 days, our group was down to two. This goes to show you that a lot of people like to talk but when it comes down to the work and the hustle, they don't show up.

This is why 90% of people who sign up for online courses or trainings never even finish them. It takes work and sacrifice and few are willing to put in the time.

But I was determined to make this work, and I did.

Back to School

After 90 days of looking at and writing one-page evaluations on 100 properties, I identified my first real estate investment opportunity.

It was a 1-bedroom/1-bath condominium, next to the beach on the island of Maui. The entire development was in foreclosure. The price for the condo was $18,000 and the seller was offering 90% financing.

This meant that all I had to do was come up with $1,800 for a 10% down payment and I could own my first property! What do you think I did? That's right - I used the bank's money to get into my first deal. All I did was hand the real estate broker my credit card for the down payment and the property was mine.

There you have it, it was really that simple. I purchased my first investment property with 100% OPM - ***I had none of my own money in the investment.***

At the end of every month, after all the expenses were paid, including debt service and management fees, the property put approximately $25 in my pocket. This was an infinite *return* on my investment. It was an infinite return because I didn't have any of my own money in the deal.

While $25 a month is not a lot of money, the lessons learned have proven to be priceless. One of the lessons learned was that *debt is money* and the other lesson was *debt is tax-free.*

Obviously, this wasn't a deal that would make me rich. But it did help me see what was possible if I could do this again in bigger arenas. That little $18,000 property on the island of Maui is worth approximately $300,000 today (I wish I hadn't sold it)!

Today, Kim and I own approximately 10,000 rental units.

We have cash flow, tax-free, every month without working, and earn more money than many people earn in a lifetime. The real estate investment process is the same for deals we do now too.

The only thing that's changed is the number of zeros on the checks we deposit.

It's All About Leverage

Leverage is my favorite thing about investing in real estate. The concept is simple and powerful. The entire real estate world functions on it.

The OPM concept is all about using money generated from someone or something other than you in order to start a business or acquire an asset. And while it's true that you can do this to an extent with stocks through buying on margin, the fact is that **there's no investment where the application of this concept is more powerful than in real estate.**

In real estate, the leverage is based on the asset itself and you can get a bank to loan you the money up to 80 percent, and sometimes even 90 to 100 percent, of the total asset value.

This means that you (personally) <u>do NOT</u> need to have a lot of money to make your first deal happen.

Why do banks do this?

It's simple - because they can repossess the physical asset (the property you borrowed against) if you default and can't pay the loan back. Buying stocks on margin, however, only allows you to borrow up to 50 percent of the stock portfolio value.

Just try to get a bank to loan you the money for buying stocks - let alone your margin! It won't happen. Ever. Instead, you have to buy through a brokerage at a high interest rate. In other words, when you buy stocks on margin, you're taking all the risk. But when you take out a loan to buy real estate, the bank is assuming the risk.

Sounds like a win right?

Debt is a Double-Edged Sword

All of this presupposes wisdom and careful planning on your part. Although debt can make you rich, suddenly if something changes that same debt can make you poor - very poor.

And that's what happened when the real estate market began to crash in 2007.

Millions of people thought they were rich because they had equity in their homes - equity that many people had used as their personal ATMs. And then, suddenly, the market crashed and they were upside down.

They owed more on their home than it was worth.

And overnight, they were *poor*.

Many lost everything because they used debt to purchase liabilities instead of using it to acquire assets (that's why Kim and I created the *CASHFLOW* board game. It's the only financial education game that encourages players to use debt to win the game).

So yes, debt can be your friend and make you incredibly wealthy in real estate. But use it wisely (to acquire assets) or it can ruin you.

Start With No Money (Here's How)

To show you how this can work out practically, here's another real-world example. This is the story of Ken McElroy's first real estate deal - Ken is a business partner of mine as well as a Rich Dad advisor.

Ken's very first investment deal was a condo that he bought, furnished, and rented out.

It was a two-bedroom unit that he put into a rental program which made it easy to lease. Similar to Airbnb, people who wanted to get away from it all could call up and rent Ken's condo (or one of a hundred others) for a weekend getaway.

Back then he only paid $116,000 with $20,000 as a down payment out of his own pocket. And yes, you might be thinking, "See, I knew you had to have some cash to get started in this business!"

But this isn't the case and here's why: ***Ken did that deal before he knew better.***

So, let's compare that deal with a later acquisition of a 182-unit apartment complex in Sun City, Arizona. The total cost for the Sun City complex was $9 million. And before you close this book and say, "this is out of my league," let me finish the story. I think it'll help you see just how simple it is to put these deals together using OPM.

The down payment was $2 million, which he raised from other investors.

So, on this later, much larger deal, Ken's out-of-pocket was literally zero.

He gave the majority of the ownership in the complex to the people who lent him the down payment. So, in essence, he formed a "partnership" with the investors. His salesmanship had nothing to do with it because ***the deal*** was the hero, not Ken. It was so good that several people wanted to be a part of it without even having to "sell them" on it. There are always *a lot of people* looking for good real estate deals.

So what was Ken's involvement here?

Primarily, *his time.*

He didn't put up any cash but he took the time to structure a deal, find investors, and leverage their cash to make it happen. You don't need money to do this - you just need a game plan. And this is a vital lesson to let sink in right now (before you even do your first deal): **partners are valuable.**

Partners help you spread your risk around by allowing you to own smaller positions in a number of properties rather than one big position in a single property. Teams always accomplish more.

And as for the return?

Which Deal Would You Rather Do (?):

1. The $116,000 property that cost you $20,000?
2. Or the one that cost you nothing but brought you a 10% ROI on a $9 million deal? For the record, that's $900,000 - I'd choose this deal any day of the week.

Today as I write this, that $9M property is worth about $20M and Ken has owned it for about 14 years. Again, he put none of his own money into the deal. But Ken did do all the work and gave the equity partners 90% ownership (called a 90/10 split).

Now that's a low split for Ken, but it was his first big deal. Since he almost made $1M on the deal, that led to more and more and more deals afterward. Here's why: Before that deal, nobody knew who Ken was. But out of nowhere, here comes this guy named Ken McElroy who buys a 182-unit building! This helped him build momentum, put him on the map, and establish himself as a serious player in the real estate game.

If Ken did it, you can, too.

This is a real possibility for you even with no cash (just like it was for Ken). When you've located a real estate opportunity, your main task will simply be finding private investors who are looking to earn a good return on their money.

Once you do, their money secures the property, everyone gets paid, and you walk away with a nice paycheck without risking any of your money or putting any cash into the deal.

Sound good?

Of course it does.

What About Tax Advantages?

Debt and taxes make:

- most people poor
- those with financial education rich

The difference? It's someone's financial IQ. Because two different people can look at the same situation and walk away with two very different outcomes. The person who has no financial education will get into bad debt and let taxes cripple him.

Now, as an adult, your financial statement *is* your report card.

And if you want to get ahead where it really counts, keep reading because it will never happen until you understand taxes.

Believe it or not, taxes work differently for different people in different "quadrants."

When I was a young boy, my rich dad showed me a diagram called the CASHFLOW Quadrant. He told me that generally speaking, the Quadrant is made up of four different types of people and everyone fits into one of the four areas.

Here's what it looks like:

Most People In The World Are Es - Also Known As "Eemployees". I don't need to explain to you what an employee is but I do want to explain to you what employees are looking for. In a word - security. They play it safe because they want the security of having a regular paycheck that's earned by trading hours for dollars.

Let me state this - there's nothing wrong with that path if that's what you choose, but you must know there are serious downfalls, too. Not only is your income dictated by what someone else thinks your work is worth, that secure, regular paycheck is also taxed at the highest rate possible. (It doesn't seem like such a good deal when you think about it that way, does it?)

Everyone should start here. You can learn valuable lessons by being an E. But if you want to get rich, you should not stay there. Which brings me to...

The S quadrant. **The S stands for the small business owner or the self-employed.** Their core value is simply, "If you want something done right, you need to do it yourself." These are the ones who are too smart for their jobs and see opportunity where most employees don't. While staying in the S quadrant can get you rich, you'll be working harder not smarter.

Which brings me to the B's. **The B stands for Big Business.** Think Bill Gates and Steve Jobs. These are the ones who don't want to do all the work themselves because they recognize the value of having others do the work for them. This runs along the same lines as OPM (other people's money). But instead of their money, those in the B quadrant use OPT, or, *other people's time.*

Lastly, the fourth and ideal place to plant your flag in the Cashflow Quadrant is the I. **The I stands for investor.** This is where I live. Investors have their money work hard *for them (*even while they're not actively involved or working on a deal). Investors wake up to money - it happens passively.

More than anyone, those in the I quadrant understand that taxes and tax breaks are incentives (and how incentives are different for the different quadrants).

People in the E and S quadrants respond to the incentive of more money, more income, higher pay, and bonuses. Those in the E and S quadrants work for money. People on the B and I side work for tax incentives. This is because they make more money, indirectly, via tax breaks.

For example, B-quadrant people receive tax breaks for hiring employees.

The government does this because the government needs jobs for people. The more jobs that exist, the better the economy does and the more money they make. This happens because there's a steady stream of tax dollars flowing into government coffers from every single employee paycheck. So the government offers the incentive of lower taxes. Think about entrepreneurs like Elon Musk. He receives billions in tax breaks from different states and from the federal government because of this.

Now over here in the I quadrant, I receive tax breaks for investing in apartment complexes. This is key to grasp as a real estate investor. *They pay me* because If I didn't provide housing, the government would have to (as they do in many places) which would end up costing American taxpayers a lot of money.

So rather than ask taxpayers to pay higher taxes, the government offers entrepreneurs like me tax incentives and I become a "partner" with the government.

Think about it this way - if the US Government had to build those apartment buildings, it'd be pure Socialism. But, if I build them, it's Capitalism (and I prefer to be a Capitalist).

But even the E and S quadrants receive tax incentives.

In the United States, for example, those who purchase houses can deduct the interest expense on their tax return. Those who save for retirement can deduct their investments through IRAs, RRSPs, and Superannuations. Those who give to charity can deduct their donations. These are all tax incentives from the government.

The B and the I quadrants simply receive many more tax incentives from the government because the activities that take place in those quadrants perform vital functions that help the government do its job of improving the economy, providing jobs, and providing food, energy, and fuel to citizens and businesses.

As a budding real estate investor, you need to understand the different quadrants as well as the different types of tax incentives. Because as in Investor, the government will pay you handsomely for buying and selling real estate.

One More Note On Taxes

Another great advantage of real estate is tax-deferred money. There are many ways a real estate investor can avoid paying taxes ever—legally. One way is known as the 1031 tax-deferred exchange. Last year, Kim and I sold a small apartment house and made over a million dollars in capital gains. By following the rules of the 1031 exchange, we were able to reinvest that money without having to pay taxes.

Tax-deferred treatment is not available for people who invest in stocks, bonds, and mutual funds. You'd be surprised how fast you can get rich if you reduce or eliminate taxes.

If you're brand new to all of this, be encouraged. You don't need to be rich or work 120 hours a week to make it work. *All you need to do is become financially literate.* Because you can use OPM (other people's money), OPT (other people's time), ***and*** get the government to PAY YOU (through tax incentives) for investing.

If you use the one thing you do have right now wisely (your time), you'll be joining me in the I quadrant in no time.

There Is a Strategy For Everyone

As you are starting to see, there are several ways you can get your first deal in real estate.

There's no one way to get started. But like I did before my rich dad gave me a financial education, most people think they have to start with a small property and work their way up to a bigger one.

That's not a bad strategy, and many people become successful investors by doing it that way. In fact, my first investment property was a two-bedroom condominium that I furnished and rented out to vacationers.

But that's just one way.

You can start with a larger property, too. Or maybe it's an inheritance property you decide to flip, or a vacation home you decide to sell. Whatever method you decide on, the principles are still the same.

As much as you possibly can, strive to use OPM, OPT, and get the government to pay you for it afterward.

But maybe you feel like you can't qualify for a loan when it comes to larger buildings. And that would likely be the case if you were looking at getting into a single-family house or a condominium you wanted to purchase as an investment. In those cases, the loan is secured by your personal assets. Even my partner and I had a hard time once acquiring a loan for a few hundred thousand dollars. It was for some small condominiums we ended up purchasing in Las Vegas, but the problem was we had our money in other real estate assets (since liquidity is something we wanted to avoid).

Because the property was smaller scale, the bank was looking for cash assets only. It didn't matter to them that we had multiple millions in real estate assets.

However, when it came time to get the multi-million-dollar loan required for our 356-unit acquisition in Oklahoma City, we didn't have any trouble at all - from the same bank!

The lesson here is that larger investment properties are secured ***by the asset itself*** (meaning, the actual property) because their values are based on performance. And everyone involved in the deal expects the property to pay them back through its operations.

So it's an easy loan for the bank (or, investors) to make. That's why I tend to steer new investors toward larger multi-family deals rather than small single-family ones. Unless you have a lot of cash on-hand, the bank will likely deny your loan.

Another way to get started is by house flipping. This means that you buy a house for a low price, rehab it, and then sell it at a profit. With just one of these deals you can make more than most people make in an entire year if you do it right. The key to flipping (and, well, any investing) is to buy low and sell high. This is known as investing for capital gains, and while it may seem easier to get started this way, you must rely on the market doing what you want to make it work. Your ultimate goal is to invest for cash flow - once you can do that, you'll be making money no matter what the market does.

As Warren Buffet says, "Be fearful when others are greedy and greedy when others are fearful."

This is why you can get in and scoop up houses for next to nothing when the economy is bad and sell them for a huge profit when the economy is good. But you have to know your exit strategy in advance. If you don't, you could wind up over-leveraged, under-funded, and in big trouble. And while house flipping can be very lucrative, just know that people who flip properties have to work much harder to turn a profit and pay a significantly higher tax rate when it's all said and done.

While I do occasionally flip properties, I prefer other ways of investing in real estate.

Because I invest for cash flow, my favorite strategy is to buy a property, rent it, then buy another and another. In the long run, I work less, make much more money, and pay less in taxes. You've already seen how I put together my first deal and how Ken McElroy put together his first deal (where he made $900k!).

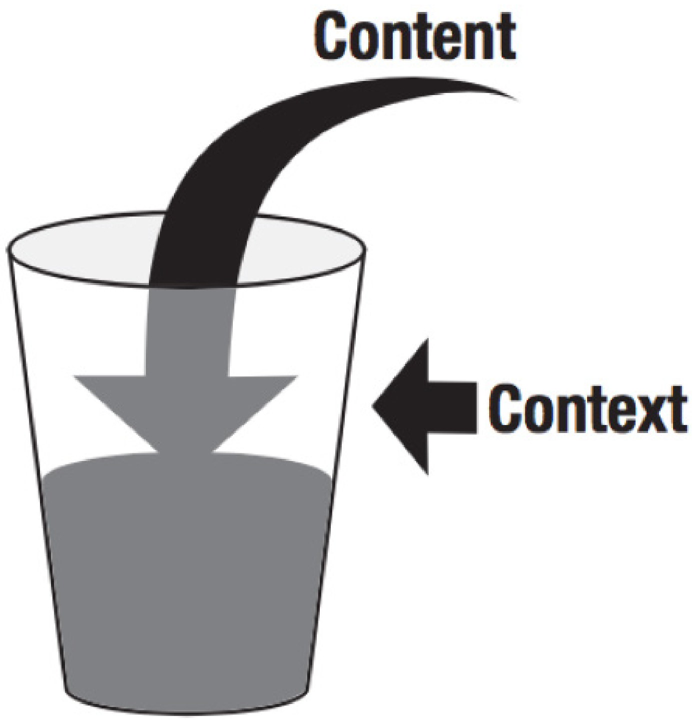
There's no single way to make this work - there are several! Each of the deals you've already read about were different.

Yet all of them were very profitable. All you have to do is find the deal that will work for you.

CHAPTER 3:

Content, Context and Why They Matter to Real Estate Investing

In one of my classes, a young woman asked, "What's the first step in finding profitable real estate deals?" Before replying, I drew on my flip chart the following picture:



I then said, "In 1989, two years after the market crashed and a recession set in, Kim and I were working our plan. It was a slow plan. Kim and I had agreed that we would buy two pieces of real estate a year for ten years. As the market crashed, we found more and more deals as more and more people panicked. In less than a year, we had purchased five small rental properties, each with a positive cash flow.

I estimate that we had looked that over 600 properties just to find those five small houses that made investment sense. But now the market was getting worse and more and more deals were appearing.

The problem was, we were out of money."

"So you had opportunities, but you were out of money?" the young woman asked.
Pointing to the glass on the flip chart, I said, "I realized that we were that the limits of our context, our reality."

"So it was time to change your reality?" asked another student.

Nodding, I said, "Yes. It was time to change or miss a window of opportunity."

The class was quiet and listening intently.

Knowing that I had their attention, I asked, "How many of you have seen an opportunity but were unable to take advantage of it?"

Most of the class raised their hands.

"When that happens," I said, "it means that you are at the boundaries of your context—what you think is possible for yourself— and that the boundaries of your content—the accumulated knowledge by which you handle problems and challenges."

"Then what happens?" asked a student. "What should we do?"

"Most people give up, saying, 'I can't do it,' or 'I can't afford it.' Many will ask friends for their opinion, and some friends will tell them to play it safe and not to take risks."

"So what did you do?" asked a student. "What did you do when you realized your plan was too slow, there was a window of opportunity, and you were out of money?"

"Well, the first thing I did was admit to myself that I was being a tortoise who wanted to quit, and it was not time to quit. It was time to push on. I also knew that it was time to become more of a swan than a duckling. Keeping the lessons from those fairy tales in mind, I continued instead of giving up. I knew that I did not know what to do, but I knew I had to do something. Days of not knowing what to do turned into weeks. One day after Kim and I had just come back from a trip, I was putting our suitcases down when the phone rang. The phone call was from my favorite real estate broker, who said in an excited voice, 'I just found the deal of the day. If you are interested in it, I'll give you a half-hour head start before I tell another one of my clients.'"

"What kind of deal was it?" asked a student.

"He told me it was a 12-unit apartment house that was in a great area and it was only $335,000 with $35,000 down, and the seller was anxious to sell. The broker then faxed me the sales data on the property with a rough pro forma on income and expenses."

"Did you buy it?" asked the student.

"No," I said. "I told the broker to give me half an hour and I would drive out immediately to look that it. When I got there, I realized why it was such a great deal so I dashed to a phone and told the broker I would take it."

"Even though you did not have the money?" asked another student.

"We had nothing," I said. "We had just purchased the last of our five units and we were really strapped for cash because we were investing in real estate as well as reinvesting in our business. Then, even though we had no money, I offered the sellers what they were asking for, which was $35,000 down and they would carry the $300,000 at 8 percent interest for five years. It was such a great deal that I could not pass it up."

"Why was it such a great deal?" asked another student.

"There were many reasons. One was because the owners lived on the property, and they had never raised the rents. The tenants were their friends, and they did not have the heart to ask them for more money, so the rents were that least 25 percent below market.

Another reason was that the couple was too old to manage the property, and they just wanted to move out. Not being sophisticated investors, they did not appreciate the value of their property. They were also afraid that the value of their property would fall in value with the recession so they were very anxious to sell.

Another reason it was a good investment was because there was also a new computer-chip factory being built just a mile from the property and more than a thousand new employees were going to be moving into the area, which again meant higher rents.

But it was the fact that I did not have to go to a bank to borrow the money that really made the deal a good one. So I called my broker and I told him that I would give them their full price and terms. My only problem was now to find the $35,000 in 30 days, which was when the couple wanted to move out."

"So for 30 days you kept asking yourself, 'How can I afford it?'" asked a student.

"Well, for two nights, Kim and I tossed, turned, sweated, and worried," I said. "We were not asking how we could afford it. We kept asking ourselves why we were so crazy. I kept asking myself, 'Why am I doing this? We're doing fine. Our investments are working. Why do I have to push the boundaries of my comfort zone?' I kept thinking about the $35,000. I realized that $35,000 was more than many people earned pretax in a year, and now I had to come up with $35,000 cash in a month. I wanted to quit. My self-confidence was challenged. I felt inadequate, stupid, and foolish. After four nights, I finally calmed down, and then I began to ask, 'How could we afford it?'"

"So how did you afford it?" asked a student. "Or did you afford it?"

"Finally, after sweating, praying, and doing our best not to quit, we took the paperwork to our bank and presented our story to the bank manager. After he turned us down, I asked him why he turned us down, and what I could have done better. After he told me, I went to the next bank with the first banker's improvements, and was again turned down. After being turned down the second time, we again asked the banker why.

By the fifth bank, I had learned a tremendous amount about what information banks wanted, why they wanted it, and how they wanted it presented to them. Then, even though our presentation was much better, we were still turned down by the fifth bank.

Almost ready to quit, Kim and I went to the sixth bank. This time, we were much better prepared. We also knew why the investment was a good investment. In trying to convince the five bankers, we had convinced ourselves even more of this investment's soundness.

This time our presentation was clearer and much more professional. We spoke the words bankers wanted to hear. Our numbers were clear, and we included our track record with our five other properties. We could now explain in banker's words and numbers why it was a great investment.

The sixth banker said yes. He had the $35,000 check for us in two days. With three days to spare, we went to the escrow office and bought the 12-unit apartment house."

"What happened after that?" asked a student.

"The real estate market continued to slide, and we kept buying," I replied. "Even though we still had very little money, we kept buying.

By 1994, the market turned up and we were financially free for the rest of our lives. That 12-unit apartment building sold for over $500,000 in 1994 and had put over $1,100 a month in our pockets during that period. The $165,000 in capital gains was rolled tax-deferred into a 30-unit apartment house, which is one of the apartment houses we still have today. That 30-unit apartment house began putting a little bit more than $5,000 a month in our pockets.

With the other properties and investments we had, we were earning over $10,000 a month in passive income, which put us at the affluent level, and we retired. We had about $10,000 in passive income and about $3,000 in monthly expenses. We were financially free."

"So it was not luck," said a student. "Your plan got accelerated."

"We were prepared for the window of opportunity, and we took it," I said. "Soon after 1994, the prices of real estate skyrocketed, and it became a little harder to find such bargains and willing sellers."

"So you made quite a bit of money without any of your own money?" asked a student.

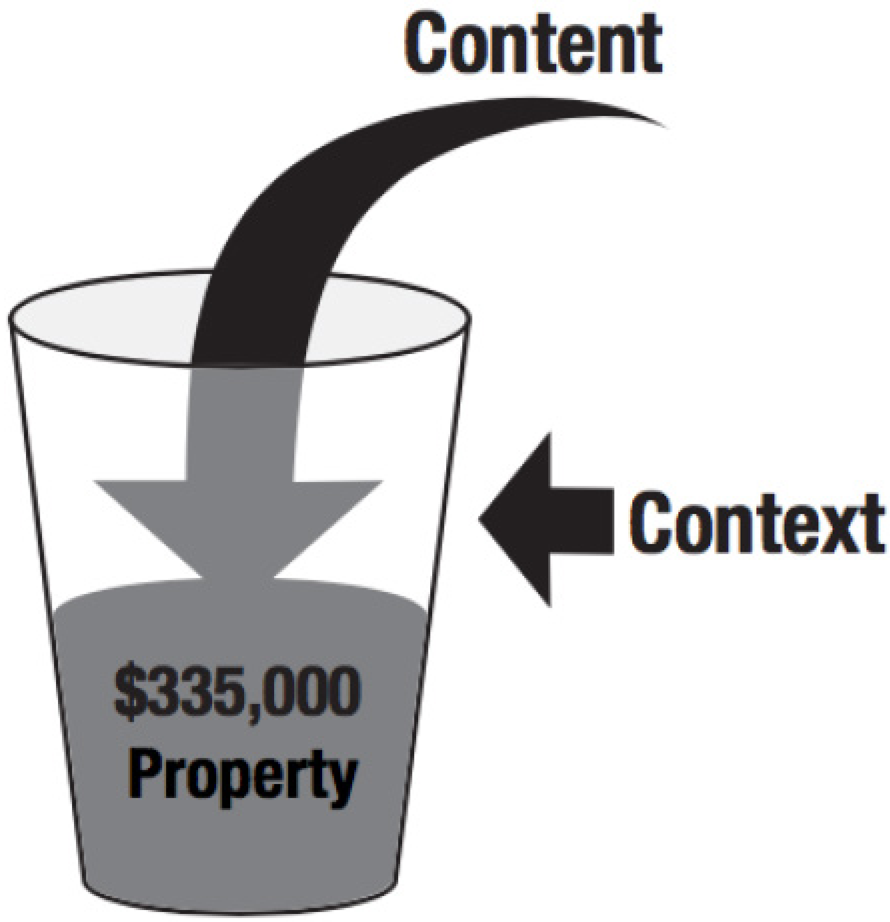
"Yes, on that deal, but I do not recommend you doing what we did. Investing in real estate without any money down can be very risky if you do not know what you are investing in and if you do not have the cash reserves if things do not go the way you expect them to. I have met many people who bought a property with nothing down, only to find out that the expenses of the property were far greater than the actual income they received.

I have had friends who have gone bankrupt because they purchased property or businesses that were too highly leveraged. That is why I do not openly endorse buying no-money-down real estate. I recommend having some experience buying, selling, and especially managing real estate before going after highly leveraged deals. We had looked at hundreds of other properties before buying this particular 12-unit property, and we also had the cash flow from our business to support any unexpected losses from the investment.

The trouble with no-money-down real estate deals is that there is often too much leverage. That type of highly leveraged investment can easily eat you alive if anything should go wrong. So I repeat: I do not recommend anyone do what we did. I tell you this story for only one reason."

"And that reason is?" asked another student.

Going to the flip chart, I then added to the drawing I had put up there previously:



"The reason I tell you this story is to explain to you the importance of being willing to expand your context as well as add to your context."

"So today, affording a $335,000 property is easy for you because you increased your reality and your education?" asked a student.

"Very easy," I replied. "Looking back upon it now, it seems silly to have let a $35,000 down payment seem like a lot of money, and a 12-unit apartment house seem like a big deal. But back then, it was a lot of money, and it was a very big deal. The important thing for Kim and me was the willingness to go beyond our context and our content."

"So most people do not push beyond their comfort levels," said another student. "Most people find it easier to play it safe and say, 'I can't afford it.'"

"That has been my experience," I said. "I believe that one of the main reasons why less than 1 percent of the population goes beyond the affluent level is simply because most people find it very uncomfortable going beyond their personal reality, their context, and their content. Most people try and solve their financial problems with what they know, rather than expand what they know so they can solve a bigger problem. Rather than taking on bigger financial challenges, most people wrestle all their lives with financial problems they feel comfortable with. They remain poor but pretty swans, rather than risk becoming an ugly duckling again."

"Have you become an ugly duckling again?" asked a student a little cynically.

"Sure," I said. "After the $335,000 apartment house, we found it easy to invest up to the $2.5 million level. From 1994 to 2001, we did well in that range up to $2.5 million and our passive income increased to about $16,000 a month without much effort. We were definitely that the affluent level, and it was time to move on to be rich.

For those of you who know our past, you may recall that *Rich Dad Poor Dad* was written between 1995 and 1996 in rough draft. I designed and created the CASHFLOW board game in 1996, and I got back into the world of business. Simultaneously in 1996, I knew it was time for me to learn how to take a company public through the IPO process, which is when I met Frank, as described in book number three, *Rich Dad's Guide to Investing*. Also in 1996, Rich Dad Poor Dad was published. We founded CASHFLOW® Technologies, Inc. In the fall of 1997. We were entering a new world with a new context, content, and friends. Our real estate investing context remained that $2.5 million in investments."

"So you moved to expand your context in other areas, but did not expand your real estate reality. This that what you are saying?" asked a student.

"That is exactly what I am saying," I said. "Our little company grew far beyond our wildest dreams. After working for five years with Frank, we had four to six companies ready to go public through the IPO process. Both in business and in the IPO process, our reality on what is possible has expanded considerably. Our context in business and the IPO process has taken quantum leaps."

"But your reality in real estate remained the same," said a student. "It has remained the same since the $335,000, 12-unit apartment house. It has remained stuck between $335,000 and $2.5 million. That is your lesson, isn't it?"

"Exactly," I said. "Just because a person improves in one financial arena does not mean they expand in all arenas. That is why in 2001, Kim and I decided it was time to get back to real estate and push the walls of our context again."

Getting Rich Gets Easier

Years ago, rich dad said to me, "One of the reasons the rich get richer is because, once you've found the formula to getting rich, it gets easier to get rich. If you never find the formula, getting rich always seems hard and staying poor seems natural."

The reason I have spent so much time on this subject of reality, context, and content is because it was rich dad's formula. It was his basic formula to never say, "I can't afford it," or "I can't do it." He chose instead to expand his reality.

As you already know, rich dad used fairy tales and Biblical stories as his life-guiding lessons to keep him going through times of doubt and fear. But it was his lesson on acceleration of wealth that was most interesting to me. He would say, "Once you know that the formula to getting rich is to continually expand your reality which increases your leverage, then getting rich becomes easier and easier. For people who become stuck in one reality and think their reality is the only reality, the speed that which they can become rich goes down."

In other words, rich dad taught me that once you become rich, getting richer is easier and becomes faster. If you never become rich, life becomes harder and slower. Knowing this, I knew it was time for Kim and me to expand our reality on real estate again. We had invested over five years expanding our reality on business and the IPO process, and we had become rich much quicker and faster than ever before.

I knew that the next level, getting richer would become easier and faster. I knew because I saw it happen to my rich dad.

After $5 Million, It Gets Very Easy

Late in the year 2000, the stock market was crashing, our business was expanding rapidly, our books and games were selling worldwide, and the companies we were bringing public were taking shape nicely and soon to be profitable.

Kim said to me, "I want to get back into real estate. We need to invest in more stable assets if we want to maintain our wealth."

With that, we went back out into the market and ran into our old reality, our old context and content. It felt like we were back again, trying to find $35,000 for a $335,000 apartment house. Then, even though we could easily write a check for three $335,000 apartment houses, paying cash without needing a loan, we were having trouble again. Things were not coming our way. That that point, I knew it was time to expand our reality one more time.

Up until then, Kim and I were looking for projects that ran around $4 million.

We felt comfortable with that number since we knew we had over $1 million for the down payment if we needed it. We thought we knew a lot, but we could not find a property or the financing that made sense or that worked according to our new plan. Then I called an old friend named Bill, who does hundreds of millions of dollars in real estate. After finally tracking him down, I asked him what was wrong with our approach.

Bill's reply was, "Four million dollars is a tough market. Banks don't like investments that big, and projects of that size are not exciting enough for sophisticated private investors. But after $5 million, it gets easy again."

The moment he said that, I knew I was that the boundary of my reality, my context. Four million dollars was easy and comfortable, but $5 million was now just outside my comfort zone. My mind began to scream, saying, "If I can't get a bank interested in a $4 million project, how will I get them interested in a $5 million project?"

I could hear my reality speaking loudly to me. I could also hear rich dad telling me to remember the fairy tales and to also remember that getting rich gets easier the richer you get, if you just follow the formula.

I knew it was time to follow the formula and push beyond my reality.

It Got Very Easy

At the start of this book, I wrote about borrowing money from the banks and investors to fund your deals (remember - it's best to use OPM). Once Kim and I were willing to push beyond our reality, our comfort zone, we found out that it is just as easy to borrow money from the *government*.

I have written about the tax laws being in favor of those who are in the B and I quadrants and against those in the E and S quadrants. And most of the people who complain about taxes are E's and S's. That's because the government wants to be the partner of the B's and I's since they create jobs and provide housing. I had always known this, because my rich dad had told me, but I had no idea how much the government helps those that help the government until I began looking into real estate investments over $5 million. There was no way of knowing until I was willing to expand my context.

Our search was on.

We were now looking for larger projects that were far beyond our comfort zone. At our first meeting in 2001 with a real estate salesperson who specialized in low-income government-sponsored housing, Kim and I showed the salesperson our existing real estate portfolio. In our portfolio we had millions of dollars in real estate, mainly in unit sizes of 30 to 50 apartments.

"You know how to manage multifamily apartment houses," said the real estate agent, a woman in her late thirties. "That's good."

"Why is that good?" asked Kim.

"Because one of the government's requirements is that anyone it lends money to must have a successful track record that managing multifamily apartment houses. You've been doing that for over ten years and have run them profitably. Many people want these government loans, but very few people qualify for them," said the agent. "As you know, most people who do own a few investment properties want to manage their own real estate, collect their rents, and do their own repairs. That is why they never learn how to manage larger properties as you do."

Kim and I nodded.

We knew there was much more to real estate than simply collecting rent and fixing a few toilets. We had learned a lot in the last ten years. But now it was time for us to move on. If we were to move on, we had to meet new people, learn a new vocabulary, and be willing to play a much bigger game.

Listening to these two new people in our lives, I realized that over the past ten years we had become hares and swans in the real estate market up to $4 million. We were the proverbial big fish in a small pond. It was now time to move on and again become uncomfortable, become slow tortoises and ugly little ducklings in a much bigger game.

Sitting next to the agent was an investment banker who specialized in tax-exempt, rated and non-rated government housing bonds. When I asked him what kind of financing programs the government had, he replied, "If you and your project qualify, the government will offer you 95-percent to 110-percent financing."

"You mean they will lend us all of the money? The government will give us the money to buy our asset?"

"Even more if you qualify," he said. "The government will even lend you the money to fix up or rehabilitate the project if you qualify."

"You mean if the project costs $10 million, they will lend us all of the $10 million or more? And if it takes $3 million to fix the place up, they will also lend us that money? They will lend us all the money for our property?"

The investment banker nodded.

"They would prefer to lend you $20 million or more, but $10 million would be a good place for you to start. Once you do a $10 million project, a $20 million or even a $50 million project would not be out of line, if you have a proven track record."

I could hear rich dad saying that things got easier and easier, but I could not believe it could become this easy. Still in a little disbelief, I asked, "At what kind of terms?"

"I might be able to secure interest rates between 5 percent to 7 percent, fixed for 40 years, and non-recourse."

"Non-recourse?" I gasped. "You mean the government won't come after everything I own personally if the project goes bad and I can't pay the money back? My banker hates non-recourse loans. Then every time I borrow money from him, he makes sure everything I own is also on the line."

"That's correct," said the investment banker. "But you realize that there are many terms and conditions that apply here that do not apply to conventional bank financing."

"I realize that," I said. "But I had no idea how good the government could be."

"Occasionally, there are even better programs in these tax-exempt government bond issues. There are occasionally forgivable loans, where the government simply forgets you borrowed money from them if you do certain things well. It is very similar to a grant."

"Why does the government do this?" I asked.

"Because one of the great problems facing this country is low-income affordable housing. The government is afraid that without people like you, millions and millions of people will go homeless and be forced to live in substandard, crime-ridden slums. The government is going after slumlords and taking some of them to jail. These slumlords prey on the poor, and the government wants to put a stop to them. That the same time, the government is willing to offer billions of dollars to individuals like you who have proven themselves to be responsible managers of large multifamily projects."

"They are willing to give me the money to become even richer."

"That is correct," said the investment banker as the real estate broker smiled on.

"It's more than just money. It's big money. If you do well over the next few years, I can help you borrow billions of dollars if you want to get that big and that rich. Last year, one of our divisions had to return over a billion dollars because they could not find anyone who qualified for it."

It was Kim who said, "The best thing about getting rich this way is that we do a lot of good for a lot of people. It excites me to think about turning a slum into safe housing for people with families."

"That's exactly what the government wants you to do. Most of our problems come from our slums. It is from our slums where crime breeds and grows. If you can change slums into safe housing, you will have more and more money available to you. As much as you want."

"So we become rich by becoming partners with the government?"

"As rich as you want to be," smiled the investment banker. "All you have to do is do what you have been doing for the past ten years, which is own and manage multifamily apartment houses. All you have to do is capitalize on your ten years of experience. And we would love to help you get even richer. Do you know how hard it is to find people with your years of experience? Just let us know when you're ready. She'll help you find your property, and I'll find you all the money you want."

The meeting was soon over.

Kim and I thanked them and headed for our car. Once in the car, we sat quietly in almost stunned disbelief. It took a number of miles before we said anything. Finally Kim said, "Do you remember the 12-unit apartment house we bought ten years ago?"

"I was just thinking about it," I replied.

"What would have happened if we had chosen to say, 'I can't afford it'?" she asked. "What would our lives be like if we had let $35,000 stop us?"

I thought for a moment and said, "I think we would still be saying the same thing today. If $35,000 had stopped us back then, it would probably be stopping us today."

As we drove out of the parking lot, I could hear rich dad saying, "Your future is determined by what you do today, not tomorrow."

Turning to Kim I said, "If we had said 'I can't afford it' ten years ago, we would probably be saying 'I can't afford it' today."

We drove home in silence, feeling excited and blessed.

I could hear rich dad telling me that once you become rich, getting rich becomes easier and easier. I could hear him saying to me that the reason many people never go past the middle-class level of life is because they do not believe in fairy tales. Since they do not believe in fairy tales, they fail to learn the lessons from the stories. As I got out of the car, I silently thanked my rich dad and could hear him saying to me, "Always remember that fairy tales do come true, in one way or another."

CHAPTER 4:

Rich Dad's Idea of Real Estate School

The CASHFLOW Quadrant Explained Further

Throughout this book, I will be referencing the CASHFLOW Quadrant. It is a great tool for identifying where you are financially and determining where you want to be.

WHICH QUADRANT ARE YOU IN?

This is the CASHFLOW Quadrant. The letters in each quadrant represent:

E for employee

S for small business or self-employed

B for big business (500 employees)

I for investor

Each of us resides in at least one of the four sections (quadrants) of the CASHFLOW Quadrant. Where we are is determined by where our cash comes from. Many of us are employees who rely on paychecks, while others are self-employed. Employees and self-employed individuals reside on the left side of the CASHFLOW Quadrant. There individuals see real estate as a place to reside, not an investment.

The right side is for individuals who receive their cash from businesses they own or investments they own. Here you will find real estate investors who buy properties to rent, flip or rent and flip. This is the goal of this book, to move you from an E or S quadrant, into the B and I quadrants using real estate.

The CASHFLOW Quadrant is an easy way to categorize people based on where their money comes from. Each quadrant within the CASHFLOW Quadrant is unique, and the people within each one share common characteristics. The quadrants will show you where you are today and will help you chart a course for where you want to be in the future as you choose your own path to financial freedom. While financial freedom can be found in all four of the quadrants, the skills of a B or I will help you reach your financial goals more quickly. Successful E's need to become successful I's to ensure their financial security during retirement.

What Do You Want to Be When You Grow Up?

Poor Dad's Advice

Growing up, my highly educated, but poor, dad always said, "Go to school, get good grades, and find a safe secure job." He was recommending a life path that looked like this:

Poor dad recommended that I become either a well-paid E, employee, or a well-paid S, self-employed professional, such as a medical doctor, lawyer, or accountant. My poor dad was very concerned about a steady paycheck, benefits, and job security. That's why he was a well-paid government official, the head of education for the State of Hawaii.

Rich Dad's Advice

My rich, but uneducated, dad offered very different advice. He said, "Go to school, graduate, build businesses, and become a successful investor." This book is about building a real estate business and using real estate as the primary investment on the B and I side of the Quadrant. Rich dad was recommending a life path that looked like this:

Who Is This Book For?

This book is written for people who are ready to change quadrants, especially for individuals who are currently in the E and S categories and are contemplating moving to the B or I category. This book is for people who are exploring real estate as the vehicle to drive their shift of categories.

This book is for people who are ready to move beyond job security and begin to achieve financial security. It's not an easy life path, but the prize at the end of the road, financial freedom, is worth the journey.

Beginning in Real Estate

I get asked all the time how I got started with real estate investing.

Well, it wasn't my idea - it came to me from my rich dad!

As I mentioned earlier, when I returned from Vietnam in 1973, rich dad suggested I begin my financial education by taking classes on real estate investing.

"Get my real estate license?" I asked.

Rich dad laughed and said, "No. Real estate licenses are for people in the S quadrant. You want financial education for the I quadrant."

Real estate agents work for *ordinary income* and real estate investors work for *portfolio* and *passive income.* Of course there's nothing wrong with having a real estate license, but most real estate brokers are not real estate investors.

As rich dad often said, "The reason they are called *brokers* is because they are *broker than you.*"

The $385 seminar I mentioned earlier where I was formally introduced to real estate investing was a pivotal moment for me. Yet it wasn't because I learned something, but more so because I *did something.*

I didn't sit around and wait for something to happen, instead, I proactively made something happen. When I asked rich dad if he thought my going to a seminar a good thing or a bad thing, he smiled and said:

"How would I know? I haven't done the course. There's only one way to find out. You just do it. You'll always learn something. Doing something is better than what most people do... which is nothing."

Academic Man vs. Seminar Man

Poor dad was an academic man. He believed in traditional education. If a Brand-Name University did not present the course, it was not real education. If the instructor did not have PhD after their name, the instructor was not a real teacher.

Rich dad however, was a seminar man.

He especially loved Dale Carnegie courses. To him, they were practical, useful, and a relatively inexpensive investment in terms of both money and time. Rich dad was not concerned with the teacher's credentials. He was more concerned about the teacher's charisma. If the instructor was boring, he was certain the Carnegie company wouldn't tolerate it. They'd fire the instructor. So he was pretty sure that the instructors would hold his attention and teach him a few things.

Poor dad was especially concerned about degrees and titles. He loved moving from high school valedictorian, to Bachelor of Arts degree, to Master's degree, to PhD. Titles and degrees are important in the world of the E and S quadrants.

Rich dad was only concerned about achieving success in the B and I quadrants.

Which do you think is worth more in the long run? A hard-earned piece of paper? Or an education that lasts a lifetime and *pays dividends*?

Nowadays, with student loans being what they are, who can even afford to go to a traditional college anyhow? The answer is not most people. This is why the price of education keeps going up, even though the quality keeps going down.

Education is making life more and more expensive for taxpayers, parents, and students. And ironically, *money*, the very subject not taught in schools, is costing all of us a lot more money. Our greatest expense is a world run by highly educated—but financially illiterate—leaders.

I'm thankful that rich dad steered me in the right direction. If not for his mentorship, who knows - I may have been saddled up with student loan debt even to this day.

Everyone Needs a Mentor

When I was nine years old, in the fourth grade, I raised my hand and asked my teacher, "When will we learn about money?"

The question seemed to take my teacher by surprise. I sensed my question was out of place. Was a question about money, inappropriate in a classroom? Sputtering and a bit indignant, she answered my question stating, "Money is not a subject taught in school."

"Why not?" I asked. "Why am I in school?" I asked.

"To get a good job." She replied.

"But don't I want a job. I want to be rich."

"No. You're in school to get a good education so you can get a job and earn money." she replied tersely, turning and walking away.

"But if I do not learn about money in school, when will I learn about money?"

She had crossed to the other side of the room, attending to another student. "Why don't you ask your dad." She replied glancing over her shoulder. "He's my boss. He should have the answer you are looking for."

My dad was the Superintendent of Education for the Island of Hawaii. For those not familiar with Hawaii, there is the State of Hawaii and the Island of Hawaii. At the time, my dad was Superintendent of the Island of Hawaii. Later, he would rise to become Superintendent of the State of Hawaii.

Confident my dad would have the answer, I went home and asked him the same question and received the same answer. Money is not a subject taught in school. My dad said, "The government tells us what we can and cannot teach. Money is a subject we cannot teach."

When I asked "Why?" He simply said "I do not know."

My poor dad, being a great teacher, recommended I talk to my best friend's father saying, "I am a government employee. Your friend Mike's father is an entrepreneur. I think he may have the answers you are looking for."

The next day after school, I rode my bike over to Mike's house. Mike wasn't there, so I picked up my bike again and rode over to his dad's place business. As I pulled up to the curb, I saw Mike standing next to his dad. He waved and I walked over to them.

"Hi Mike…" I said. Turning to his dad, I shyly asked, "Can I ask you a question?"

"Of course," he replied.

"I asked my teacher, and then I asked my dad, and neither one of them knew the answer to this, but my dad thought you might know…"

"What is it?"

"Why don't we learn about money in school? It seems like a pretty important topic, but when I asked my teacher when we would learn about it, she got upset and told me it wasn't what she was supposed to teach me."

He looked at me appraisingly for a minute. "Tell me, why do you want to learn about money? What is it you want to know?"

I looked down and drew circles in the dirt with my toe. "I want to know because I want to be rich one day. I don't want to get a job - I'd rather be rich."

Mike's dad chuckled.

Shocked at this response, I said, "Why is that funny? My teacher won't tell the answer, my dad won't tell me the answer - when will someone tell me?

Rich dad looked me in the eye and said, "You cannot teach what you do not know."

Mike chimed in, "What do you mean? Teachers don't know about money?"

"No," rich dad replied. "Teachers - and most parents - are a product of the current system. Usually, they're working on a small salary, struggling with debt. How can teachers teach what they do not know? The reason they do not know is they were brought up in the same system."

I looked at rich dad speculatively, trying to understand. "So school doesn't teach us about money because they don't know about it?"

Rich dad nodded.

"Then why is education so important? I thought we were meant to get an education so we could grow up and get money," I questioned.

Rich dad answered, "Schools do not give you an education in making money. They tailor education to getting a job. These two things are very different. That approach may serve some people well, but it does not serve anyone who is interested in becoming rich."

And thus my financial education began.

From the age of nine until well into my thirties, rich dad was my teacher, mentor, coach and guide to my future. If not for my rich dad, I suspect, I would have wound up a highly educated poor man, much like my real dad. In 1997, Rich Dad Poor Dad was published and the Rich Dad Company was formed. The company was founded to teach the world financial education the same way my rich dad taught his son and me.

Rich Dad Taught His Son And Me By:

1. Playing games (simulations), making mistakes, and learning from our mistakes using play money. Playing games requires physical intelligence, the primary way humans learn.

2. Doing the real thing, working as apprentices in his office and visiting his "green houses"— then witnessing him buy his "red hotel" 10 years later.

3. Using simple pictures—diagrams of financial statements, the CASHFLOW Quadrant, and the B-I Triangle.

4. Participating in discussion, teaching us to cooperate, respecting the opinions and wisdom of others, and not needing to be the smartest person on the team... because business is a team sport. In school, participating in a discussion and asking for help is cheating.

Although I was an average student all through school, today I make much more money than my smart classmates who went on to be doctors, airline pilots, and attorneys - the very classmates who were taught in school that cooperating is cheating.

5. Inspired learning: My rich dad did not give his son and me answers. Instead, he inspired us to learn and find our own answers. Today, I spend a lot of time reading books and attending lectures. The difference is that I'm studying because I want to learn, not because I need to pass a test.

So what does this have to do with real estate?

In short - everything.

Because those who are successful in real estate are the ones who have guides and mentors helping, coaching, and leading them along the way. For example, my friend and mentor, Dr. Alexander Elder, author of the best seller *Trading for a Living* states that it takes about five years and $50,000 to learn to be a professional trader.

I agree.

It took me about five years before I became a professional real estate investor. *The difference was, it did not take me $50,000 to learn.* Learning to become a *real,* real estate professional investor meant learning to use debt, taxes, and phantom income, not traditional money.

And it was my mentor (rich dad) who gave me the real world education I needed to bypass all the fluff and jump straight into real estate.

Real-world education requires:

- A willingness to learn.
- Choosing your teachers wisely - for example, be careful who teaches you about money. You do not want someone from the E quadrant teaching you about the I-quadrant.
- Practice - this is a most important word. Remember this: professional soccer players practice five *days* for every *day they play*. Musicians *rehearse* for years before becoming rock stars. Doctors and lawyers call their *business a practice* - they practice on you and me.

Practice is the environment where you make mistakes and correct. The more important the lesson, the more you should practice. For example, the closer I got to going to Vietnam, the more my flight crew and I practiced.

- Courage - to take action and put the learning and the practice into real action.

Also, bear in mind that *physical intelligence* is the master intelligence. The moment you start *doing* something, the other intelligences fall in line.

Real Estate Investor Strategy (aka the Best Investment)

To be a good Real Estate Investor, you need to understand investing as a whole first.

Yet the average investor doesn't know the difference between investing for cash flow and investing for capital gains. Most investors invest for capital gains, hoping and praying the price of their stock or home goes up. As long as you have more cash flowing in than flowing out, your investment is a good investment.

Keep in mind that it's not the asset class that makes a person rich or poor. For example, when a person asks, "Is real estate is a good investment?" I reply, "I don't know. Are you a good investor?" Or if they ask, "Are stocks a good investment?" Again my answer is the same, "I don't know. Are you a good investor?"

My point is that it is never the investment or asset class that's important. Success or failure, wealth or poverty, depends solely on how smart the investor is. A smart investor will make millions in the stock market.

An amateur will lose millions.

Tragically, most people do not think learning to invest is important. This is why most people believe investing is risky and turn their money over to "experts," most of whom are not really investors, but salespeople who make money whether the investor makes money or loses money.

Building Blocks From My Rich Dad

Previously, I explained how I learned about money while working for my rich dad from the age of nine into my college years. In exchange for my labor, he would spend hours teaching his son and me the ins and outs of running a business, as well as the skills needed to be an investor.

There was many a Saturday I would have rather been surfing with my friends or playing some other sport, yet I found myself sitting in my rich dad's office, learning from a man who would one day become one of the wealthiest private citizens in Hawaii.

During one of these Saturday lessons, my rich dad asked his son Mike and me, "Do you know why I will always be richer than the people who work for me?"

Mike and I sat blankly for a while, searching our minds for an appropriate answer. At first, it seemed like a stupid question, but knowing rich dad, we knew there was something important to learn from his question.

Finally, I gave what I thought was the obvious answer.

"Because you make more money than they do," I said. "Yeah," Mike said, nodding in agreement. "After all, you own the company, and you decide how much you get paid and how much they get paid."

Rich dad rocked back in his chair, grinning.

"Well, it is true that I decide how much everyone gets paid. But the truth is, I get paid less than many of the employees who work for me."

Mike and I both looked at his dad with a suspicious gaze.

"If you own this business, how can other people be paid more than you?" Mike asked.

"Well, there are several reasons why," replied rich dad.

"Do you want me to tell you?"

"Of course!" Mike replied.

"Well, when you're starting up a business, cash is often tight, and the owner is usually the last to be paid."

"You mean the employees always get paid first?" asked Mike.

Rich dad nodded.

"That is correct. And not only do they get paid first, they often get paid more than I do when I do get paid."

"But why is that?" I asked. "Why own a business if you get paid last and get paid the least?"

"Because that is what a business owner often needs to do that first if he plans to build a successful business."

"That makes no sense," I replied. "Tell me why you do it then."

"Because employees work for money, and I work to build an asset," said rich dad.

"So as you build this business, your pay will go up?" Mike asked.

"It may and it may not. I say this because I want you to know the difference between money and an asset," rich dad continued. "I may or may not pay myself more later on, and I am not working hard for the paycheck. The reason I work hard is to build an asset that increases in value. I may someday sell this business for millions of dollars, or I may hire a president to run it for me one day, and I will go on to build another business."

"So to you, building a business is building an asset. And the asset is more important to you than money," I said, doing my best to understand the distinction between money and an asset.

“That’s right,” said rich dad.

“And the second reason I get paid less is that I already have other sources of income.”

“You mean you have money from other assets?” I asked.

Again rich dad nodded.

“And that is the reason I asked you boys the question in the first place. That is why I asked you why I will always be richer than my employees, regardless of who makes the most money in salary. I am doing my best to teach you a very important lesson.”

And what is the lesson?” asked Mike.

“The lesson is, you don’t get rich at work. You get rich at home,” said rich dad strongly, making sure we did not take his words lightly.

“I don’t understand,” I admitted. “What do you mean, you get rich at home?”

“Well, it’s at work where you earn your money. And it is at home where you decide what you are going to do with your money. And it is what you do with your money after you earn it that makes you rich or poor,” replied rich dad.

“It’s like homework,” Mike said.

“Exactly,” said rich dad. “That is exactly what I call it. I call getting rich my homework.”

“But my dad brings a lot of work home,” I said almost defensively, “and we’re not rich.”

“Well, your dad brings his work home, but he really does not do his homework,” said rich dad. “Just as your mom does housework, but that is not what I mean by homework.”

“Or yard work,” I added.

Rich dad nodded.

“Yes, there is a difference between yard work, the schoolwork you bring home, the work your dad brings home from his office, and the kind of homework I am talking about.”

It was then my rich dad said something to me I have never forgotten:

“The primary difference between the rich, the poor, and the middle class is what they do in their spare time.”

"Their spare time?" I said in a questioning tone.

"What do you mean, their spare time?"

Rich dad smiled that his son and me for a moment.

"Where do you think this restaurant business was started?" he asked. "Do you think that this business came out of thin air?"

"No," said Mike. "You and Mom started this business at our kitchen table. That is where all your businesses have been started."

"That's correct," said rich dad.

"Do you remember the first small store we started years ago?"

Mike nodded. "Yes, I do," he said.

"Those were very tough days for the family. We had so little money. And how many stores do we have now?" asked rich dad.

"We own five," Mike replied.

"And how many restaurants?" asked rich dad.

"We own seven," said Mike.

As I sat there listening, I began to understand a few new distinctions.

"So the reason you earn less from this restaurant is that you have income from many other businesses instead of *just one*?"

"That is partly the answer," rich dad said with a grin.

Learning Monopoly & Cash flow

"The rest of the answer is found on this Monopoly game board. Understanding the game of Monopoly is the best kind of homework you can do."

"Monopoly?" I asked with a grin. I could still hear my poor dad's voice telling me to put my Monopoly game away and do my homework. "What do you mean, Monopoly is homework?"

“Let me show you,” said rich dad as he opened up the world’s most familiar game.

“What happens when you go around ‘Go’?” he asked.

“You collect two hundred dollars,” I replied.

“So every time you go around ‘Go,’ that is like you collecting your paycheck. This that correct?”

“Yeah. I guess so,” said Mike.

“And to win the game, what are you supposed to do?” asked rich dad.

“You’re supposed to buy real estate,” I said.

“That’s right,” said rich dad.

“Buying real estate is your homework. That is what makes you rich. Not your paycheck.”

Mike and I sat there in silence for a long period of time. Finally, I ventured a question to rich dad.

“So are you saying a big paycheck does not make you rich?”

“That’s correct,” said rich dad.

“A paycheck does not make you rich. It is what you do with that paycheck that makes a person rich, poor, or middle class.”

“I don’t understand,” I said. “My dad is always saying that if he got a bigger pay raise, we would be rich.”

“That is what most people think,” said rich dad.

“But the reality is that the more money most people make, the further in debt they get. So they have to work harder.”

“Why is that?” I asked.

“It’s because of what they do that home. It’s what they do in their spare time,” said rich dad.

“Most people have a poor plan or a poor formula for their money after they make it.”

“So where does a person find a good formula for wealth?” Mike asked.

“Well, one of the better formulas for wealth is found right here on the Monopoly board,” rich dad said, pointing to the game board.

"What formula?" I asked.

"Well, how do you win the game?" asked rich dad.

"You buy several pieces of real estate, and then you begin putting houses on them," Mike answered.

"How many houses?" asked rich dad.

"Four," I said. "Four green houses."

"Good," said rich dad.

"And after you have those four green houses, then what do you do?"

"You turn those four green houses in and buy a red hotel," I said.

"And that is one of the formulas for great wealth," said rich dad.

"Right here on the game board of Monopoly, you have one of the best formulas for wealth in the world. It is a formula that many people have followed to become richer beyond their wildest dreams."

"You're kidding me," I said with a bit of disbelief. "It can't be that simple."

"It is that simple," rich dad confirmed.

"For years I have taken the money I have earned in my business and simply bought real estate. Then what I live off the income from my real estate and continue to build my businesses. The more money I make from my businesses, the more money I invest in real estate. That is the formula of great wealth for many people."

"If it is so simple, why don't more people do it?" asked Mike.

"Because they don't do their homework," said rich dad.

"Is it the only formula for wealth?" I asked.

"No," said rich dad. "But it is a very sound plan that has worked for many wealthy people for centuries. It worked for kings and queens of old, and it still works today. The difference is that today you don't have to be nobility to own real estate."

"So you have been playing the game of Monopoly in real life?" asked Mike.

Rich dad nodded.

"Years ago, when I was a kid playing Monopoly, I decided that my plan for great wealth was to build businesses and then have my businesses buy my real estate. And that is all I have been doing. Then, even when we had very little money, I was still going home and looking for real estate."

"Does it have to be real estate?" I asked.

"No," said rich dad, "but when you get older and begin to understand the power of corporations and tax law, you will understand why real estate is one of the best investments."

"What else can you invest in?" asked Mike.

"Many people like stocks and bonds," said rich dad.

"Do you have stocks and bonds?" I asked.

"Of course," said rich dad, "but I have more real estate."

"Why?" I asked.

"Well, it's because my banker will give me a loan to buy real estate, but he frowns on giving me a loan to buy stocks. So I can leverage my money better with real estate, and the tax laws favor real estate. But we're getting off the point."

"What is the point?" I asked.

"The point is, you get rich at home, not at work," said rich dad. "I really want you to understand that. I don't care if you buy real estate or stocks or bonds or build a business. I do care that you understand that most people do not get rich at work. You get rich at home by doing your homework."

"I got the lesson," I said.

"So when you finish working here at the restaurant, where do you go next?"

"Glad you asked," said rich dad. "Come on. Let's get in my car and take a ride. I'll show you where I go after work is done."

A few minutes later, we arrived at a large tract of land with row after row of houses on the land.

"This is 20 acres of prime real estate," rich dad said, as he pointed to the land.

"Prime real estate?" I said cynically.

I may have been only 12 years old, but I knew a low-rent neighborhood when I saw one.

"This place looks terrible."

"Well, let me explain something to you," said rich dad.

"Think of these houses as those green houses on the Monopoly board. Can you see that?"

Mike and I nodded slowly, doing our best to stretch our imaginations.

These houses were not the neat, clean, green houses on the Monopoly board.

"So where is the big red hotel?" we asked almost simultaneously.

"It's coming," said rich dad. "It's coming. But it's not going to be a red hotel. Over the next few years, our little town will grow out in this direction. The city has announced plans to locate the new airport on the other side of this property."

"So these houses and land will be between the town and the airport?" I asked.

"You got it," said rich dad.

"Then, when the time is right, I will tear down all these rental houses and convert this land into a light industrial park. And then I will control one of the most valuable pieces of land in this town."

"Then what will you do?" Mike asked.

"I will follow the same formula," said rich dad.

"I'll buy more green houses and, when the time is right, turn them into red hotels or light industrial parks or apartment houses or whatever the city needs that time. I'm not a very smart man, but I know how to follow a successful plan. I work hard, and I do my homework."

Later that day, he drove his son and me out to see his real green houses. He had about five acres of them. "One day," he said, "I will have my big red hotel." Taking a moment to gather his thoughts, he said, "There are many different formulas. This is the formula I will follow for the rest of my life. I do not have an education. I did not go to school like you boys. Although not formally educated, I will dedicate my life to learning to have this formula work for me."

He kept his word.

Rather than go to traditional schools, rich dad often flew from our little town of Hilo, Hawaii, to Honolulu, the capital, on another island, to attend business, sales, and investment courses. His goal was not to get a college degree so he could get a job.

He didn't want a job.

His goal was to get an education that would fuel his plan to great wealth.

Ten years later when I was 19 years old, I returned home from school in New York for Christmas break. For our New Year's celebration, rich dad's son and I had a roaring party in the penthouse of rich dad's real red hotel on the beach at Waikiki.

After midnight, when the party was over, I stood on the balcony of his penthouse staring at Waikiki Beach in front of me, realizing rich dad had played Monopoly in real life. He had followed his plan.

In ten years, I witnessed him going from poor to very rich.

By the end of his life, he had five red hotels on different islands and many other properties, businesses, and assets.

Today, when back in Hawaii, I often drive by buildings his family still owns and continues to collect income from, even though rich dad is no longer with us. Even after death, he remained a rich man.

As you may know, hanging onto your wealth can be as hard as achieving wealth. That is why, before he became wealthy, rich dad also took courses in Honolulu on taxes, probate, and asset protection.

When I asked him why, he said, "It does not make sense to work hard and have someone or the government take your money from you. If you are not smart, the government will take most of your hard-earned money after you die. Your stockbroker won't return your money after it's lost in a market crash. If you are not smart, an accident or illness can wipe you out. If you are not smart, a lawsuit can take most of your hard-earned money. Before you make your money, you need to learn how to protect it."

Rich dad never finished high school, yet he never stopped his education.

After Kim and I were married, while we were building our business and our investments, we allocated three to four times a year for business or investment education. The good thing about building a business and working on our investments was that we could apply what we learned immediately.

Together, we took classes on advertising, gold, options trading, writing sales letters, foreign-exchange trading, creative financing, foreclosures, and asset protection. Like rich dad, this is how Kim and I gained and continue to increase our financial knowledge.

In other words, rich dad did not teach me any specific subject. Instead, he taught me how to learn and what to learn.

And today, like rich dad, we study hard so we can play Monopoly in real life.

In Rich Dad Poor Dad, rich dad's lesson number one was that the rich do not work for money. Instead, the rich focus on having their money work for them. As a young boy, I will always remember the impact of comparing the lesson from the game board of Monopoly to the lesson in real life with my rich dad and many other very wealthy individuals.

Their wealth was really gained in what rich dad called *"doing their homework."*

For me, the idea that wealth was gained at home and not at work was a powerful lesson from my rich dad. My real dad brought a lot of work home, but he did very little homework.

In contrast, I did something different.

The information gained from my rich dad and the $385 real estate course I first took have bought my wife and I something far more important than job security over the past several decades. It's bought us financial security and financial freedom.

We worked hard, and we also did our homework.

For A True Investor, The Market Doesn't Matter

When my rich dad suggested I take classes on real estate investing, he advised, "If you want to be a successful capitalist, you must know how to raise capital and how to use debt to make money."

That year was the start of my education into the world of the capitalist.

My real-life education had begun. I was learning to use other people's money to make money, a skill a true capitalist must know.

In 1974, my contract with the Marine Corps was up, and I took a job with the Xerox Corporation in Hawaii, not because I wanted to climb the corporate ladder, but because Xerox had the best sales-training program. Again, this was all part of my rich dad's educational program to train me to become a capitalist.

By 1994, Kim and I were financially free, never needing a job or a company or a government retirement plan. Rich dad was correct. My education could set me free - *but not the education found in traditional schools.*

When the markets began to crash in 2007, rather than crash with the rest of the economy, our wealth skyrocketed. As the stock market and real estate markets crashed, great deals floated to the surface, and banks were more than eager to lend us millions of dollars to buy and take over their investments gone bad. In 2010 alone, Kim and I acquired over $87 million in real estate, using loans from banks and pension funds.

That year was our best year so far.

As rich dad often said, "If you're a true investor, it doesn't matter if the markets are going up or coming down. A true investor does well in any market condition."

Investing Is A Game

So...how do you prepare for the life of an investor?

As I mentioned, the game of Monopoly is a game of cash flow. Over and over again, rich dad would say, "One of the great formulas for wealth is found in the game of Monopoly. Always remember the formula: four green houses, one red hotel."

For example, if you had one green house on a property you owned and you received $10, that was $10 a month in cash flow. Two houses, $20. Three houses, $30. And the red hotel, $50. More green houses and more red hotels mean more cash flow, less work, less taxes, and more freedom. A simple game—but an important lesson.

Rich dad played Monopoly in real life.
He would often take his son and me to visit his green houses—green houses that would one day become a big red hotel, right on Waikiki Beach. As I grew up and watched my rich dad play the game of Monopoly in real life, I learned many valuable lessons about investing.

Some of those lessons are:

- Investing is not risky
- Investing is fun
- Investing can make you very, very rich
- More importantly, investing can set you free—free from the struggle of earning a living and worrying about money
- In other words, if you were smart, you could build a pipeline of cash flow for life—a pipeline that would produce cash in good times and bad, in market booms and market crashes.

Your cash flow would increase automatically with inflation and, that the same time, allow you to pay less in taxes.

Kim and I took that same investment formula, applied it to real life, and grew wealthy and financially free. Even when the real estate market was really bad, we bought as many small houses as we could with the limited money we had. When the market improved, we traded in the four green houses and bought a large red hotel.

Now we never have to work again because the cash flow from our large red hotel, apartment houses, and mini-storages units pays for our lifestyle again and again and again.

Your Homework

The game of Monopoly taught me how to see into the future.

And because of my rich dad's mentor ship and guidance, I believe the advantage I had over other kids who also play Monopoly was that my financial IQ was higher than most.

I knew the difference between assets and liabilities, businesses, real estate, stocks, and bonds, and so much more. But most people didn't. Because we're not taught about these things growing up.

In 1996, I developed my CASHFLOW board games to be a bridge between Monopoly and the real world. If you like the game of Monopoly and are interested in building businesses or investing, then Rich Dad games are the next step in the educational process.

My educational games are a little bit more difficult to learn and may take a little longer to learn and master, but make sure you check them out and play them with your kids and loved ones.

Because once you've learned them, you too, may begin to see your future after just a few hours of playing a game.

CHAPTER 5:

The 6 Lessons of the Rich

Once you've got the basics of concepts like cash flow, you too, can see your future. Here are a few basic lessons that will get you started.

These are the core lessons from my book *Rich Dad Poor Dad*, and you must understand each one in order to succeed building personal wealth - whether you're investing in real estate or not.

Lesson One - The Rich Don't Work for Money

I spent many hours as a child sitting at a table in one of rich dad's restaurants as rich dad discussed the affairs of his business.

During these discussions, I would sit and sip my soda while rich dad talked with his bankers, accountants, attorneys, stockbrokers, real estate brokers, financial planners, and insurance agents. It was the beginning of my business education.

Between the ages of nine and eighteen, I spent hours listening to these men and women solve intricate business problems. But those lessons around the table ended when I left for four years of college in New York, followed by five years of service with the Marine Corps.

When my college education was complete and my military duty nearly over, I was ready to continue the lessons with rich dad. I called rich dad, ready to begin my lessons again.

Rich dad had turned the businesses over to Mike and was now semi-retired. He was looking for something to do rather than play golf all day. While Mike was busy running their empire, rich dad and I had lunch at a hotel on Waikiki Beach. The sun was warm, the ocean beautiful, the breeze light, and the setting as close to paradise as you can get.

Rich dad was shocked to see me walk in wearing my uniform. He had never seen me in uniform before. He had only seen me as a kid, dressed in casual clothes like shorts, jeans, and T-shirts. I guess he finally realized I had grown up since leaving high school, and had seen a lot of the world and fought in a war. I wore my uniform to the meeting because I was between flights and had to get back to the base that evening.

"So that is what you have been doing since leaving high school," said rich dad.

I nodded my head and said, "Four years at the military academy in New York, and four years in the Marine Corps. One more year to go."

"I am very proud of you," said rich dad.

"Thanks," I replied. "But it will be nice to get out of a military uniform. It's really tough being spit on or stared at, or called 'baby-killers' by all these hippies and people who are against the war. I just hope it ends soon for all of us."

"I'm glad Mike did not have to go," said rich dad. "He wanted to enlist, but his poor health kept him out."

"He was fortunate," I replied. "I lost enough friends to that war. I would have hated to have lost Mike too."

Rich dad nodded and asked, "So what are your plans once your military contract is up next year?"

"Well, three of my friends have been offered jobs with the airlines as pilots. It's tough getting hired right now, but they say they can get me in through some contacts they have."

"So you are thinking of flying with the airlines?" asked rich dad.

I nodded slowly. "Well, that's all I've been doing—thinking about it. The pay is okay, and benefits are good. And besides, my flight training has been pretty intense," I said. "I've become a pretty good pilot after flying in combat. If I fly for a year with a small airline and get some multi-engine time, I will be ready for the major carriers."

"So is that what you think you are going to do?" asked rich dad.

"No," I replied. "Not after watching my dad struggle late in life. Now that I've seen how you and Mike live, I realized if I took a job with the airlines, I might someday become a mid-level investor. But I realized I might never go beyond that level."

Rich dad sat in silence, nodding ever so slightly. "So what I said hit home," he said in a low voice.

"Very much so," I replied. "I reflected on all the lessons you gave me as a kid. Now I'm an adult and the lessons have a new meaning to me."

"And what did you remember?" asked rich dad.

"I remember your taking away my 10 cents per hour and making me work for free," I replied. "I remember that lesson of not becoming addicted to a paycheck."

Rich dad laughed at himself and said, "That was a pretty tough lesson."

"Yes it was," I replied, "but a great lesson. My dad was really angry with you then. But now he's the one trying to live without a paycheck at 52 years old. I was only nine when I got that lesson. After lunch at Mike's yesterday, I vowed I would not spend my life clinging to job security just because I need a paycheck. That's why I doubt I will seek a job with the airlines. And that's why I'm here having lunch with you. I want to review your lessons on how to have money work for me, so I don't have to spend my life working for money. But this time, I want your lessons as an adult. Make the lessons harder and give me more detail."

"And what was my first lesson?" asked rich dad.

"The rich don't work for money," I said promptly. "They know how to have money work for them."

A broad smile came over rich dad's face. He knew I'd been listening to him all those years as a kid. "Very good," he said. "And that is the basis of becoming an investor. All investors learn how to have their money work hard for them."

"And that is what I want to learn," I said quietly. "I want to learn and maybe teach my dad what you know. He is in a very bad way right now, trying to start over again at the age of 52."

"I know," said rich dad. "I know."

So on a sunny day, with surfers riding the beautiful waves of the deep blue ocean, my lessons on investing began. The lessons came in phases, each phase taking me to a higher level of understanding rich dad's thought process and his investment plan.

The lessons began with preparing mentally and taking control of myself—because that's the only place investing really takes place anyway. Investing ultimately begins and ends with taking control of yourself. The lessons on investment in Phase One of rich dad's investment plan are all about the mental preparation it takes before actually beginning to invest.

Lying in my bunk that night in 1973 in a dingy room on the Marine Corps base, my mental preparation had begun. Mike was fortunate enough to have a father who had accumulated great wealth. I was not that fortunate. In many ways, he had a 50- year head start on me. I had yet to start.

That night, I began my mental preparation by choosing between seeking job security, the road my poor dad chose, and pouring a foundation of real wealth, the road my rich dad chose. That is where the process of investing truly begins and where rich dad's lessons on investing start.

It starts with a very personal decision—a mental choice to be rich, poor, or middle class. It is an important decision because, whichever financial position in life you choose—be it rich, poor, or middle class—everything in your life then changes.

Lesson Two - Why Teach Financial Literacy

"A business has a financial statement, a stock certificate is a reflection of a financial statement, every real estate property has a financial statement, and each individual human being has a financial statement," said rich dad.

"Every security and human being?" I asked. "Even my dad? Even my mom?"

"Sure," said rich dad. "Everything—regardless of whether it is a business, stock, real estate, or human being—that transacts money has an income statement and balance sheet, whether or not they know it. People who are not aware of the power of a financial statement often have the least money and the biggest financial problems."

"You mean like my dad is having right now," I said.

"Unfortunately, that is true," said rich dad. "Not knowing the simple difference between assets and liabilities, earned income from passive and portfolio income, and not knowing where they all appear and how they flow on a financial statement has been a costly oversight for your dad."

"So when you look at a business, you look at the financial statement, not the price of its stock that day?" I asked, doing my best to move the discussion away from my dad.

"Correct," said rich dad. "That is called fundamental investing. Financial literacy is fundamental to fundamental investing. When I look at the financials of a business, I look at the guts of a business. When I look at the financials, I can tell if the business is fundamentally strong or weak, growing or declining. I can tell if the management is doing a good job or wasting a lot of the investors' money. The same is true with an apartment building or office building."

"So by reading the financials, you can tell for yourself if the investment is risky or safe," I added.

"Yes," said rich dad. "The financials of a person, a business, or a real estate property will tell me much more than that. But a cursory look at a financial statement does three more important things."

"And they are?"

"For one thing, being financially literate gives me a checklist of what is important. I can look at each line and determine what is not being done right, or what I can do to improve the business and make things right. Most investors look at the price and then the stock's P/E, or Price/Earnings ratio. The P/E of a stock is an outsider's indicator of the business. An insider needs other indicators, and that is what I will teach you. Those indicators are part of a safety checklist to make sure all the parts of the business are functioning well. If you're not financially literate, you cannot tell the differences. Then, of course, investing becomes risky for that person."

"And the second thing?" I asked.

"The second thing is when I look at an investment, I overlay it on my personal financial statement and see where it ts. As I said, investing is a plan. I want to see how the financial statement of the business, the stock, the bond, or the real estate will impact my personal financial statement. I want to know that this investment will get me to where I want to go. I can also analyze how I can afford the investment. By knowing my numbers, I know what will happen if I borrow money to buy an investment and the long-term impact balanced with income and out flow due to debt payments."

"And the third thing?"

"I want to know that this investment is safe and will make me money. I can tell if it is going to make money or lose money in a very short period of time. So if it does not make me money, or I cannot fix the reason why it will not make me money, why should I buy it? That would be risky."

"So if you do not make money, you don't invest?" I asked.

"In most instances," said rich dad. "Yet as simple as that sounds, it always amazes me when I meet people who are losing money or making no money and they think they are investors. Many people who invest in real estate lose money every month and then say, 'But the government gives me a tax break for my losses.' That is like saying, 'If you lose a dollar, the government will give you 30 cents back.' A few very sophisticated business people and investors know how to use that government ploy to their advantage, but very few people really do. Why not make a dollar and get an additional 30 cent bonus from the government? That is what a real investor does."

"People actually do that? They actually lose money and think it's investing?"

"On top of that, they think losing money for tax advantages is a good idea. Do you know how easy it is to find an investment that loses money?" asked rich dad.

"I imagine it would be pretty easy," I said. "The world is filled with stocks, mutual funds, real estate, and businesses that don't make any money."

"So a real investor first wants to make money, and then after making money, they want an additional bonus from the government. So a real investor will make a dollar as well as get a 30-cent bonus from the government. An unsophisticated investor will lose a dollar and be thrilled to get 30 cents from the government in the form of a tax write-off."

"Just because that person cannot read a financial statement?" I asked.

"That is one of the basics. Financial literacy is definitely an important investor basic at the rich investment level. The other basic is to invest to make money. Never invest with the intent to lose money and then be happy with a tax write-off. You invest for one reason only—to make money. Investing is risky enough without investing to lose money."

As we ended the lesson for the day, rich dad said, "Now do you realize why I had you do your personal financial statements so often?"

I nodded and said, "As well as analyze the financial statements of businesses and real estate investments. You kept saying you wanted me to think in financial statements. Now I understand why."

"While you were in school, you got a report card once a quarter. A financial statement is your report card once you leave school. The problem is that since most people have not been trained to read financial statements or trained in how to keep a personal financial statement, they have no idea how they are doing once they leave school. Many people have failing marks on their personal financial statements but think they are doing well because they have a high-paying job and a nice home. Unfortunately, if I were handing out the grades, anyone who was not financially independent by age 45 would receive a failing grade. It is not that I want to be cruel. I just want people to wake up and maybe do a few things differently, before they run out of their most important asset—time."

"So you reduce risk by being able to read financial statements," I replied. "A person needs to get his or her personal financial statement under control before investing."

"Definitely," said rich dad. "This whole process I have been talking about is the process of taking control of yourself, which also means your financial statement. So many people want to invest because they are deep in debt. Investing in the hopes of making more money so you can pay bills or buy a bigger house or a new car is a fool's investment plan. You should invest for only one reason: to acquire an asset that converts ordinary earned income into passive income or portfolio income. That conversion of one form of income into another form of income is the primary objective of a true investor. To do that requires a higher degree of financial literacy than simply balancing a checkbook."

"So you're not concerned about the price of a stock or a real estate property as much as the operating fundamentals that you can see with a financial statement?"

"Right," said rich dad. "That is why I got upset when you were concerned about the stock market prices. While price is important, it is far from the most important thing in fundamental investing. Price is more relevant in technical investing, but technical investing is another lesson. Now do you understand why I had you do so many personal financial statements and analyze businesses and real estate investments?"

I nodded. "I hated it at the time, but now I'm glad you had me do so many of them. I realize now how much I analyze things using mental pictures of my financial statement. I visualize how what I do with my money is affecting my financial statement. I did not realize that most people do not think with these types of visual reference points."

"You are far ahead of the game," said rich dad, "the game of getting rich. I have a term for the income statement and the balance sheet, the two primary reports that make up financial statements— the magic carpet."

"Why do you call them the magic carpet?" I asked. "Because they seem to magically take you behind the scenes into any business, any piece of real estate, and any country in the world. It is much like taking a diving mask and suddenly looking below the surface of the water. The mask, symbolizing the financial statement, lets you see clearly what is going on beneath the surface. Alternatively, a financial statement is like having Superman's X-ray vision. Instead of trying to jump over the tall building, a financially literate person can see right through the building's concrete walls. Another reason I call them the magic carpet is that they free you to see and do so many things in so many parts of the world while sitting at your desk. You can invest in so many parts of the world or just in your backyard with so much more knowledge and insight.

Improving my financial literacy ultimately reduces my risk and improves my investment returns. A financial statement lets me see what the average investor cannot see. It also gives me control over my personal finances, and that allows me to go where I want to go in my life. Having control over financial statements also allows me to operate multiple businesses without being in the business physically.

Truly understanding financial statements is one of the keys necessary for a person in the S quadrant to move to the B quadrant. And that is why I call the income statement and balance sheet the magic carpet."

Lesson Three - Mind Your Own Business

In 1974, Ray Kroc, the founder of McDonald's, was asked to speak to the MBA class at the University of Texas at Austin. A friend of mine was a student in that MBA class.

After a powerful and inspiring talk, the class adjourned and the students asked Ray if he would join them at their favorite hangout to have a few beers. Ray graciously accepted.

"What business am I in?" Ray asked, once the group had all their beers in hand.

"Everyone laughed," my friend said. "Most of the MBA students thought Ray was just fooling around."

No one answered, so Ray asked again, "What business do you think I'm in?"

The students laughed again, and finally one brave soul yelled out, "Ray, who in the world doesn't know you're in the hamburger business?"

Ray chuckled. "That's what I thought you would say." He paused and then quickly added, "Ladies and gentlemen, I'm not in the hamburger business. My business is real estate."

As my friend tells the story, Ray spent a good amount of time explaining his viewpoint. In his business plan, Ray knew that the primary business focus was to sell hamburger franchises, but what he never lost sight of was the location of each franchise. He knew the land and its location were the most significant factors in the success of each franchise. Basically, the person who bought the franchise was also buying the real estate under the franchise for Ray Kroc's organization.

Today, McDonald's is the largest single owner of real estate in the world, owning even more than the Catholic church. McDonald's owns some of the most valuable intersections and street corners in America and around the globe.

My friend considers this as one of the most important lessons in his life. Today, he owns car washes, but his business is the real estate under those car washes.

When I was a young boy, we did not have a McDonald's nearby. Yet my rich dad was responsible for teaching Mike and me the same lesson that Ray Kroc talked about at the University of Texas. It is secret number three of the rich.

That secret is: Mind your own business.

Most people work for everyone but themselves. They work first for the owners of the company, then for the government through taxes, and finally for the bank that owns their mortgage. Financial struggle is often directly the result of people working all their lives for someone else. Many people will simply have nothing at the end of their working days to show for their efforts.

Our current educational system focuses on preparing today's youth to get good jobs by developing scholastic skills. Their lives will revolve around their wages or, as described earlier, their income column. Many will study further to become engineers, scientists, cooks, police officers, artists, writers, and so on. These professional skills allow them to enter the workforce and work for money. But there is a big difference between your profession and your business.

Often I ask people, "What is your business?"

And they will say, "Oh, I'm a banker."

Then I ask them if they own the bank.

And they usually respond, "No, I work there."

In that instance, they have confused their profession with their business. Their profession may be a banker, but they still need their own business.

A problem with school is that you often become what you study. So if you study cooking, you become a chef. If you study the law, you become an attorney, and a study of auto mechanics makes you a mechanic.

The mistake in becoming what you study is that too many people forget to mind their own business. They spend their lives minding someone else's business and making that person rich.

To become financially secure, a person needs to mind their own business. Your business revolves around your asset column, not your income column. The number-one rule is to know the difference between an asset and a liability, and to buy assets.

The rich focus on their asset columns, while everyone else focuses on their income statements. That is why we hear so often: "I need a raise." "If only I had a promotion." "I am going back to school to get more training so I can get a better job." "I am going to work overtime." "Maybe I can get a second job."

The primary reason the majority of the poor and middle class are fiscally conservative— which means, "I can't afford to take risks"— is that they have no financial foundation. They have to cling to their jobs and play it safe.

When downsizing became the "in" thing to do, millions of workers found out their largest so-called asset, their home, was eating them alive. Their "asset" was costing them money every month. Their car, another "asset," was eating them alive. The golf clubs in the garage that cost $1,000 were not worth $1,000 anymore. Without job security, they had nothing to fall back on. What they thought were assets could not help them survive in a time of financial crisis.

I assume most of us have filled out a credit application to buy a house or a car. It's always interesting to look at the "net-worth" section because of what accepted banking and accounting practices allow a person to count as assets.

One day when I wanted a loan, my financial position did not look too good. So I added my new golf clubs, my art collection, books, electronics, Armani suits, wrist watches, shoes, and other personal effects to boost the number in the asset column. But I was turned down because I had too much investment real estate.

The loan committee didn't like that I made so much money from rent. They wanted to know why I did not have a normal job with a salary. They did not question the Armani suits, golf clubs, or art collection.

Life is sometimes tough when you do not fit the standard profile. I cringe every time I hear someone say to me their net worth is a million dollars or $100,000 dollars or whatever. One of the main reasons net worth is not accurate is simply because, the moment you begin selling your assets, you are taxed for any gains.

So many people have put themselves in deep financial trouble when they run short of income. To raise cash, they sell their assets. But their personal assets can generally be sold for only a fraction of the value listed on their personal balance sheet. Or if there is a gain on the sale of the assets, they are taxed on the gain. So again, the government takes its share, thus reducing the amount available to help them out of debt.

That is why I say someone's net worth is often "worth less" than they think. Start minding your own business. Keep your daytime job, but start buying real assets, not liabilities or personal effects that have no real value once you get them home. A new car loses nearly 25 percent of the price you pay for it the moment you drive it off the lot. It is not a true asset even if your banker lets you list it as one. My $400 new titanium driver was worth $150 the moment I teed off. Keep expenses low, reduce liabilities, and diligently build a base of solid assets.

As a young boy, my educated dad encouraged me to find a safe job. But my rich dad encouraged me to begin acquiring assets that I loved. "If you don't love it, you won't take care of it."

I collect real estate simply because I love buildings and land. I love shopping for them, and I could look at them all day long. When problems arise, the problems aren't so bad that it changes my love for real estate. For people who hate real estate, they shouldn't buy it.

My real estate strategy is to start small and keep trading up for bigger properties and, therefore, delay paying taxes on the gain. This allows the value to increase dramatically. I generally hold real estate less than seven years.

For years, even while I was with the Marine Corps and Xerox, I did what my rich dad recommended. I kept my day job, but I still minded my own business. I was active in my asset column trading real estate and small stocks.

I don't encourage anyone to start a company unless they really want to. Knowing what I know about running a company, I wouldn't wish that task on anyone. There are times when people can't find employment and starting a company seems like the best solution. But the odds are against success: Nine out of ten companies fail in five years. Of those that survive the first five years, nine out of every ten of those eventually fail as well. So only if you really have the desire to own your own company do I recommend it. Otherwise, keep your day job and mind your own business.

When I say mind your own business, I mean to build and keep your asset column strong. Once a dollar goes into it, never let it come out. Think of it this way: Once a dollar goes into your asset column, it becomes your employee. The best thing about money is it works 24 hours a day and can work for generations. Keep your day job, be a great hard-working employee, but keep building that asset column.

As your cash flow grows, you can indulge in some luxuries. An important distinction is rich people buy luxuries last, while the poor and middle class tend to buy luxuries first. The poor and the middle class often buy luxury items like big houses, diamonds, furs, jewelry, or boats because they want to look rich. They look rich, but in reality they just get deeper in bad debt.

The old-money people, the long-term rich, build their asset column first. Then the income generated from the asset column buys their luxuries. The poor and middle class buy luxuries with their own sweat, blood, and children's inheritance. A true luxury is a reward for investing in and developing a real asset.

For example, when my wife Kim and I had extra money coming from our apartment houses, she went out and bought her Mercedes. It didn't take any extra work or risk on her part because the apartment house bought the car. She did, however, have to wait four years while the real estate investment portfolio grew and began generating enough extra cash flow to pay for the car. But the luxury, the Mercedes, was a true reward because she proved she knew how to grow her asset column.

That car now means a lot more to her than simply another pretty car. It means she used her financial intelligence to afford it. Instead, most people impulsively go out and buy a new car, or some other luxury, on credit. They may feel bored and just want a new toy. Buying a luxury on credit often causes a person to eventually resent that luxury because the debt becomes a financial burden. After you've taken the time and invested in and built your own business, you are now ready to learn the biggest secret of the rich— the secret that puts the rich way ahead of the pack.

Maybe this is why Alan Greenspan, former chairman of the Federal Reserve Board, said, "We need to start teaching financial literacy in our schools." We need to start teaching our kids to take care of themselves financially, rather than teaching them to expect the government or the company they work for to take care of them after they retire.

Lesson Four - The History of Taxes and the Power of Corporations

They say there are only two sure things in life: death and taxes. And nobody likes either of them.

My rich dad said to me, "When it comes to taxes, the rich make the rules."

He also said, "If you want to be rich, you need to play by the rules of the rich."

The rules of money are skewed in favor of the rich, and against the working and middle classes. After all, someone has to pay taxes.

The middle class, of course, does not like this. That is why they get so mad when they find out that the rich can avoid paying taxes and when they find out that the rich often avoid paying taxes because they help write the rules.

When it comes to conversations about taxes, most people appeal to some sense of justice. It's not fair, they cry, that the rich get to make the rules when it comes to taxes. It's unjust, they say, that the rich can avoid paying taxes while the middle class and the poor are stuck with the bill.

But as my father (and probably your father) said, "Life isn't fair."

As you probably know, the tax codes in the US and in many different countries are long and complicated. The question is, why?

The reason is government leaders learned a long time ago that the tax codes could be used to make people and businesses do what they want by utilizing the tax code.

In short, the many credits and breaks that are found in the tax code are there precisely because the government wants you to take advantage of them. For instance, the government wants cheap housing. Because of this, there are many tax credits for affordable housing that developers and investors can take advantage of to minimize their tax liability, put more money in their pocket, and in turn, create affordable housing. Everyone wins.

There are many scenarios like this in the tax code that incentivize investors and entrepreneurs to do activities the government is looking for while rewarding those who take those actions with lower-or zero-tax burden.

Because of this, limiting your tax liability actually means you're doing what the government wants you to do through the tax code. And that is the most patriotic thing you can do.
The rich use the tax code to build their wealth, and you can too.

Many people won't agree with this, but that's OK. They can keep complaining and paying their taxes. These rules won't go away, so I'd rather play by them.

There are many ways the rich make a lot of money and pay little to no money in taxes, and anyone can use them. As an illustration, here's a real-life situation in which I played by the rules of the rich and minimized my taxes:

- My wife, Kim, and I put $100,000 down to purchase 10 condominiums in Scottsdale, Ariz. The developer paid us $20,000 a year to use these 10 units as sales models. So, we received a 20 percent cash-on-cash return, on which we paid very little in taxes because the income was offset by the depreciation of the building and the furniture used in the models. It looked like we were losing money when we were in fact making money.

- Since the real estate market was so hot, the 380-unit condo project sold out early. Our 10 models were the last to go. We made approximately $100,000 in capital gains per unit. We put the $1 million ($100,000 x 10 units) into a 1031 tax-deferred exchange. We legally paid no taxes on our million dollars of capital gains.
- With that money, we purchased a 350-unit apartment house in Tucson, Ariz. The building was poorly managed and filled with bad tenants who had driven out the good tenants. It also needed repairs. We took out a construction loan and shut the building down, which moved the bad tenants out. Once the rehab was complete, we moved good tenants in and raised the rents.
- With the increased rents, the property was re-appraised and we borrowed against our equity, which was about $1.2 million tax-free, because it was a loan—a loan which our new tenants pay for. Even with the loan, the property still pays us approximately $100,000 a year in positive cash flow.
- Kim and I then invested the $1.2 million in another 350-unit apartment house in Flagstaff, Ariz., a hot property market, all tax free.

This is an example of an investment strategy known as the velocity of money. As I've written before, moving your money makes more sense than parking it in cash, bonds, equities, or mutual funds—the strategy most financial advisors recommend.

Kim and I have several such scenarios active at any one time. We have lots of monthly cash flow, which we reinvest, but we rarely have any liquid cash sitting around to be taxed.
In the above example, we started with $100,000 we earned tax-deferred from another investment. The $100,000 eventually allowed us to borrow over $20 million from banks, tax-free. How long would it take you to save $20 million by parking your money somewhere, as most financial advisors recommend?

Clearly, one of the reasons the rich get richer is because they earn a lot of money without paying much, if anything, in taxes. They know how to use banks' tax-free money to become richer.

For instance, instead of paying capital gains tax on the sale of our condo units, real estate laws allowed us to defer paying these taxes and invest them into another property instead. The cash that does come from this property goes into our pockets at a lower tax rate because there's no Social Security or self-employment tax to pay, and the tax rate is further reduced by the depreciation of the property.

On the flip side, the poor and middle-class toil away for their money, pay more in taxes the more they earn, and then park their earnings in savings and/or retirement accounts. In the meantime, they receive little or no cash flow on which to live while waiting for retirement—when they'll live on their meager savings.

Doesn't it make more sense to play by the rules of the rich, and earn more while paying less in taxes?

Lesson Five - The Rich Invent Money

I was working with a group of very bright graduate students at Thunderbird School of Global Management which recently earned the No. 1 Master in Management ranking in the *Times Higher Education/WSJ* 2019 Business Schools Report.

During the three hour session, I asked one of the young students, “What is your investment plan?”

Without hesitation, he replied, “When I graduate, I will find a job that pays me at least $150,000 a year and will put aside at least $20,000 a year to buy investments.”

I thanked him for his willingness to share his plan with me. Then I said, “Do you remember my discussion of rich dad’s 90/10 principle of money?”

“You mean that 90% of the people work to earn only 10% of the money, and that 10% of the people make the remaining 90%? Yes,” said the young man with a smile, knowing that I was about to challenge the way he was thinking. He was enrolled in the entrepreneurship program of this very prestigious school where I was a guest instructor. By now, he knew my style of teaching is not to give students answers. My style is to challenge core beliefs and ask students to evaluate old thought patterns.

“What does the 90/10 principle of money have to do with my investment plan?” he asked cautiously.

“Everything,” I replied. “Do you think your plan of finding a job and investing at least $20,000 a year will put you in the category of the 10 percent of investors who make 90 percent of the money?”

“I don’t know,” he replied. “I never really thought about my plan with that benchmark in mind.”

“Most people don’t,” I replied. “Most people find an investment plan and think it is the only investment plan or the best investment plan, but few compare their plans to other plans. And the problem is most people will not find out if their plan was the right plan until it’s too late.”

“You mean the average investor is investing for retirement and will not find out if their plan worked or not until they retire?” asked another student in the class. “They’ll find out when it is too late?”

“For many people my age, that will be true,” I replied. “Sad, but true.”

“But isn’t the idea of finding a high-paying job and putting $20,000 a year away a pretty good plan?” asked the student. “After all, I’m only 26 years old.”

“A very good plan,” I replied. “Definitely putting away more money than the average person and starting young with that much money will probably make you a very rich man. But my question is: Will your plan put you in the 90/10 league of investors?”

“I don’t know,” said the young man. “What would you advise?”

“Do you remember my telling you the story of walking along the beach with my rich dad at the age of 12?” I asked.

“You mean the story of you wondering how he could afford such an expensive piece of real estate?” another student replied. “Rich dad’s first big investment and his first move into the world of bigger investments?”

I nodded my head and replied, "That's the story."

"And that story has to do with the 90/10 rule of money?" asked the student.

"Yes, it does. It applies because I always wondered how my rich dad could acquire an asset so big even though he had very little. So after asking him how he did it, he gave me what he called 'the 90/10 riddle'."

"The 90/10 riddle?" replied one of the students. "What is the 90/10 riddle, and what does it have to do with my investment plan?"

With that question, I walked to the chalkboard and drew the following diagram. "This is the 90/10 riddle," I said.

"That's the 90/10 riddle?" asked the student. "All it looks like is a financial statement without any assets in it."

"And it is. So this is the question that completes the riddle," I said with a grin, watching the students' faces to see if they were still with me.

After a long pause on my part, one of the students finally demanded, "So give us the question."

"The question is," I said slowly, "how do you fill your asset column without buying any assets?"

"Without buying any assets?" asked the student. "You mean without any money?"

"More or less," I replied. "Your investment plan for putting $20,000 a year aside to invest is a good idea. But my challenge to you is: Is the idea of buying assets with money a 90/10 idea, or is it an average-investor idea?"

"So you're saying to create assets in the asset column instead of buying the assets with money, which is what most people do."

I nodded my head. "You see, this diagram, the diagram I call the 90/10 riddle, is the riddle that my rich dad would challenge me with on a regular basis. He would ask me for my ideas on how I could create assets in the asset column without buying them with money."

The students were silent, looking at the riddle on the chalkboard. Finally one student turned and said, "Is that why you often say, 'It doesn't take money to make money?'"

I nodded my head and replied, "You're catching on. Most people in the 90 percent who own the 10 percent often say, 'It takes money to make money.' Many often give up on investing if they do not have any money."

"So your rich dad's 90/10 riddle was to give you a blank asset column and ask you how you would fill it with assets without having to buy the assets."

"Constantly. After I came back from Vietnam, he would routinely have a lunch or dinner with me and ask me for new ideas on how to fill the asset column by creating assets instead of buying assets. He knew that's how many of the ultra-rich got rich in the first place. That's how Bill Gates, Michael Dell, and Richard Branson all became billionaires. They did not become billionaires by looking for a job and putting a few dollars aside."

"So you're saying the way to become rich is by being an entrepreneur?"

"No, I am not saying that. I just use those examples because you are all in the entrepreneurship program at Thunderbird. The Beatles became ultra-rich by creating a different kind of asset, but they created assets that still produce money today. All I'm saying is rich dad put this financial statement with a blank asset column in front of me on a regular basis and asked me how I would create assets inside the asset column without having to spend money to acquire them. He began giving me this 90/10 quiz when I asked him how he found the power to acquire a piece of the most expensive beach front land without any money."

"So he said his business bought the land," another student chimed in.

"As I said, that is one way, but there are many ways you can create assets inside an asset column without buying them. Inventors do it by inventing something of great value. Artists paint paintings that are priceless. Authors write books that pay them royalties for years. Creating a business is the way an entrepreneur does it, but you don't have to be an entrepreneur to create an asset inside the asset column. I've done it with real estate without using any money. All you have to do is be creative, and you can be rich for life."

"You mean I can invent something with new technology and become rich?" asked one of the students.

"You could, but it does not have to be an invention or new technology," I said, pausing for a while. "It is a way of thinking that creates assets. Once you have that way of thinking, you will be richer than you ever dreamed possible."

"What do you mean it doesn't have to be a new invention or technology? What else could it be?"

Doing my best to make my point, I asked, "Do you remember the story about the comic books in my book, *Rich Dad Poor Dad?*"

"Yes," said one of the students. "The story of your rich dad taking away your 10 cents an hour and asking you to work for free after you asked for a raise? He took away the 10 cents because he did not want you to spend your life working for money."

"Yes, that story," I replied. "That is a story about filling the asset column with an asset without buying the asset."

The students stood quietly for a while thinking about what I had just said. Finally one spoke up and said, "So you took old comic books and turned them into assets."

I nodded my head. "But were the comic books the asset?" I asked.

"Not until you turned them into an asset," replied another student. "You took something that was being thrown out as trash and turned it into an asset."

"Yes, but were the comic books the asset, or were the comic books merely the part of the asset you could see?"

"Oh," another one of the students jumped in. "It was the invisible thought process that took the comic book and created an asset out of it. The thought process was the real asset."

"That is how my rich dad saw it. He later told me the power he had was his thinking process. It was a thinking process he often jokingly called 'turning trash into cash.' He also said, 'Most people do exactly the opposite and turn cash into trash.' That is why the 90/10 rule holds true."

"He was like the ancient alchemists," said one of the students, "the alchemists who searched for the formula to turn lead into gold."

"Exactly," I said. "The people who are in the 90/10 grouping of money are modern-day alchemists. The only difference is they are able to turn nothing into assets. Their power is the ability to take ideas and turn them into assets."

"But as you say, many people have great ideas. They are just not able to convert them into assets," said a student.

I nodded my head. "And that was my rich dad's secret power I saw that day on the beach. It was that mental power or financial intelligence that allowed him to acquire such an expensive piece of real estate, while the average investor would walk away from it, saying 'I can't afford it,' or 'It takes money to make money.'"

"How often did he give you the 90/10 quiz?" asked a student.

"Very often," I replied. "It was his way of exercising my brain. Rich dad often said our brains are our most powerful asset and, if used improperly, they can be our most powerful liability."

The students were silent. I assume they were contemplating and questioning their own thoughts. Finally the original student, the student whose plan it was to put the $20,000 dollars a year away, said, "So that is why in your book, Rich Dad Poor Dad, one of rich dad's lessons was that the rich invent their own money."

I nodded my head and said, "And lesson number one of the six lessons was 'the rich don't work for money.'"

Again there was silence from the young students before one said, "So while we are planning on getting a job and saving money to buy assets, you were taught that your job was to create assets."

"Well said," I replied. "You see, the idea of a 'job' was created in the Industrial Age and ever since 1989, we have been in the Information Age."

"What do you mean the idea of a job is an Industrial-Age idea?" one student asked with a start. "Humans have always had jobs, haven't they?"

"No, at least not in the way we know a job today. You see, in the Hunter-Gatherer period of humanity, humans lived in tribes and each person's job was to contribute to the communal survival of the tribe. In other words, it was all for one and one for all. Then came the Agrarian Age, the era when there were kings and queens. A person's job during that period was to be a serf or a peasant who paid the king to work the land the king owned.

Then came the Industrial Age and serfdom or slavery was abolished and human beings began selling their labor on the open market. Most people became employees or self-employed, doing their best to sell their labor to the highest bidder. That is the modern concept of the word 'job.'"

"So the moment I said I'm going to get a job and put $20,000 away a year, you see that kind of thinking as Industrial-Age thinking."

I nodded my head. "Just as today there are still Agrarian-Age workers who are known as farmers and ranchers. Today there are still Hunter-Gatherers—commercial fishermen, for example. Most people are working with Industrial-Age ideas and that is why so many people have jobs."

"So what would an Information-Age idea of work be?" asked a student.

"People who do not work because their ideas are that work. Today there are students who are much like my rich dad who are going from school to becoming rich without a job. Look that many of the Internet billionaires. Some of them dropped out of college to become billionaires without ever having a formal job."

"In other words, they started with an empty asset column and filled it with a very big asset, an Information-Age asset," added one of the students.

"Many built multi-billion-dollar assets," I said. "They went from students to billionaires. Soon there will be high school students who will go from high school students to billionaires without ever applying for a job. I already know of one who is a millionaire without ever having a job. After reading my book and playing my games, he bought a large piece of real estate, sold off a section of vacant land, kept the apartment house, and paid off his loan with the money from the land. He now owns the apartment house which is worth a little over a million dollars and has cash flow of $4,000 a month income without working. He will graduate from high school in about a year."

The students stood silently again, thinking about what I just said. Some had a hard time believing my story about the high school student, yet they knew the story of college dropouts becoming billionaires was true.

Finally one spoke up, "So in the Information Age, people are getting rich with information."

"Not just in the Information Age," I replied. "It has been this way throughout the ages. It's the people who do not have assets who work for, or are controlled by, those people who create, acquire, or control the assets."

"So you're saying a high school kid could beat me financially, even though he does not have a great education from a prestigious school or a high-paying job," said the first student.

"That is exactly what I am saying. It's more about the way you think than about your education. Best-selling author Thomas Stanley states in his book, the Millionaire Mind, that his research found no correlation between high SAT scores, good grades, and money."

The student with the $20,000-a-year investment plan then said, "So if I want to join the 90/10 investor club, I am better off to practice creating assets instead of buying assets. I should acquire assets by being creative rather than by doing what everyone else does."

"That is why billionaire Henry Ford said, 'Thinking is the hardest work there is. That is why so few people engage in it,'" I replied. "It also explains why, if you do what the 90 percent of investors do, you will join them in sharing only 10 percent of the wealth."

"Or why Einstein said, 'Imagination is more important than knowledge,'" added another student.

"Or why my rich dad gave me this tip when hiring an accountant. He said when you're interviewing an accountant, ask him or her, 'What is 1+1?' If the accountant answers '3,' don't hire the person. They're not smart. If the accountant answers '2,' you also don't hire them because they are not smart enough. But if the accountant answers, 'What do you want 1+1 to be?' you hire them immediately."

The students laughed as we began packing up our materials.

"So you create assets that buy other assets and liabilities. Is that correct?" asked a student.

I nodded my head.

"Do you ever use money to buy other assets?" asked the same student.

"Yes, but I like to use the money generated by the asset I create to buy other assets," I replied, picking up my briefcase. "Remember that I don't like working for money. I'd rather create assets that buy other assets and liabilities."

A young student from China gave me a hand with my bags and said, "And is that why you recommend network marketing so much? For very little money and risk, a person can build an asset in their spare time."

I nodded my head, "An asset they can pass on to their kids if their kids want it. I don't know of too many companies that will let you pass on your job to your kids. That is one test of an asset: You can hand it on down to the people you love. My dad, the man I call my poor dad, worked very hard to climb the government ladder. Then even if he had not been fired, he would not have been able to pass on his years of hard work to his kids, not that any of us wanted the job or were qualified to take the job anyway."

The students gave me a hand out to my car.

"So think about creating assets rather than working hard and buying assets," said the $20,000 student.

"If you want to get into the 90/10 investor club," I replied. "That is why my rich dad constantly challenged my creativity to create different types of assets in the asset column without buying them. He said it was better to work years that creating an asset rather than to spend your life working hard for money to create someone else's asset."

As I climbed into my car, the $20,000 student then said, "So all I have to do is take an idea and create an asset, a big asset, that makes me rich. If I do that, I will solve the 90/10 riddle and join the 10 percent of all investors who control 90 percent of the wealth."

Laughing, I pulled my door shut and replied to his last comment, "If you solve the 90/10 riddle in real life, you will have a good chance of joining the 10 percent that control 90 percent of the money. If you don't solve the 90/10 riddle in real life, you will probably join the 90 percent that control just 10 percent of the money."

I thanked the students and drove away.

Lesson Six - Work to Learn Don't Work for Money

Remember - when I was a young man, the one thing my poor dad wanted for me was to get a high-paying job. To him, the path to success was to go to a good university, get your degree, find a high-paying job, and work your way up the corporate ladder.

As you know, I determined at a young age that wasn't going to be my path. I wanted to be rich, and I knew that working as an employee, even with a high paying job, wouldn't be the way to get rich.

This is something most rich people already know (which is partly why they are rich).

Two Mindsets About Work

My poor dad said, "Job security is the most important thing."

My rich dad said, "Learning is the most important thing."

These two statements represent two fundamentally different mindsets about work. Most people will hear advice about not worrying what you will earn, and discount it a privileged advice. "You should be paid fairly for your work!" they will say while stomping their feet. When you look at work as simply a way to make money so you can then do other things, it is impossible to think of it as a means to any other end.

But there are also those who will have a light turn on, realizing that work can be a path to something greater, even if you aren't paid or are paid very little.

In order to be successful, you have to work to learn, not to earn.

The Learning Mindset

In the movie *Jerry Maguire*, there are many great one-liners. But there is one I found particularly truthful. Tom Cruise's character is leaving his high-paying job to start his own agency after being fired, and he says, "Who wants to come with me?" The whole place is frozen and silent, looking down at him. Finally, one woman pipes up and says, "I'd like to, but I'm due for a promotion in three months."

Sadly, as mentioned above, this is the mindset of most people when it comes to work. Rather than look at work as an opportunity to grow and learn, they look at work as a necessary evil and try to get as much money from their job as possible.

As a young man, I faced the same decision as the woman in *Jerry Maguire*. After graduation from the Merchant Marine Academy, I had a good career ahead of me. My first job was on a Standard Oil of California oil-tanker fleet as third-mate. I made $42,000 a year, including overtime, and only had to work seven months of the year. My poor dad was very happy.

After six months, however, I resigned my position with Standard Oil and joined the Marine Corps. My poor dad was devastated, but my rich dad congratulated me.

The reason I joined the Marine Corps was to learn new skills. I wanted to learn how to be a pilot and to learn how to lead others into difficult situations. I knew the leadership skills I learned in the Corps would benefit me greatly in life and business.

After my tour of duty, I had the opportunity to get a steady paying job as a commercial airline pilot. Instead, however, I took a job with Xerox as a salesman. Again, my poor dad was devastated and my rich dad was happy. Though I could have had a comfortable life as a pilot, I wanted to learn the skill of sales. I knew that skill, coupled with the leadership skills I learned in the Marine Corps, would make me rich.
Specialist vs. generalist

The fundamental difference between my poor dad's philosophy and my rich dad's philosophy about work was one of specialization versus generalization.

My poor dad believed the best thing to do was to become increasingly specialized in your work. He admitted people were paid more for knowing more and more about less and less. This is why he was so proud to get his doctorate. Yet, he always struggled financially.

My rich dad believed the best thing to do was to become a generalist and to know a little about a lot. He said the best thing to do was to work in many areas of a company and pick up skills rather than a profession. He knew the best way to get rich was to be able to lead specialists across a wide spectrum of departments in a company.

Can You Cook Better Than McDonald's?

Sometimes when I'm teaching a class, I'll ask, "How many of you can cook a better hamburger than McDonald's?" Nearly everyone in the room will raise their hand. I'll then ask, "If you can cook a better hamburger, how come you're not richer than McDonald's?"

The obvious answer is McDonald's is better at business than they are at making hamburgers. They have developed sophisticated sales and business systems and skills that equal success. The reason why most people are poor is because they're so focused on making the better hamburger but not developing the best business systems and skills.

What does this look like in the real world? Going to school to get your MBA in accounting so you can be a manager at a big accounting firm while someone like Rich Dad Advisor Tom Wheelwright builds a multi-million dollar accounting practice from the lessons he learned working at a Big 4 accounting firm.

Work To Learn Not To Earn

Today, you're faced with these same choices. Will you work to earn, holding onto security over opportunity? Or, will you work to learn (and get a financial education), giving up some security to embrace greater opportunity?

Most people will follow the conventional wisdom and choose to work to earn. But if you want to be rich, I recommend you work for what you want to learn rather than what you want to earn. Figure out what skills you want to acquire before choosing a specific profession and before getting trapped in the rat race.

CHAPTER 6:

My First Real Estate Course

During the Agrarian Age, it was only the kings and queens - the Aristocrats - who owned the land.

This is back when the world was largely an agricultural society. The people at the top controlled it all. And if you weren't at the top as one of the urban elite, most likely you were at the bottom - *a peasant.*

The word *peasant* is derived from the French words, *pays* and *sants*- people who worked the land, but did not own the land. And the words *real estate*, in Spanish, mean *royal estate*. Even back then, the sole differentiator between the rich and poor - was land ownership. Real estate. If you had it you were rich. If you didn't, you spent your whole life working *for* the rich. And it's not much different throughout the ages, even up to today in the 21st Century.

But let's fast forward from the Agrarian Age to the Industrial Age. While a lot has changed, we still see the same socio-economic hierarchy.

During the Industrial Age, the aristocracy was made up not of Kings and Queens, but of industrial giants such as Henry Ford, John D. Rockefeller, and JP Morgan. Ford produced cars, Rockefeller produced the gasoline, and Morgan produced the money.

There's always been an elite class of rulers.

In the Information Age (which started in the 1970's and is still here), the new aristocracy are the tech wizards who control cyber-real estate. These are people such as Apple co-founder Steve Jobs, Jeff Bezos of Amazon, and Google Co-founders Sergey Brin and Larry Page.

When the world "lives" online, it's those who control the internet that rule.

During the Agrarian Age, the rich were called aristocracy. Today they're called Capitalists. These are the ones who live in the "I Quadrant." These are the ones who are investors.

They understand business, they understand investing, and they're financially intelligent.

What's A Child To Do?

Now, I think we can all agree—everyone wants their children to be successful.

They want their kids to be at the top of the pyramid, not the bottom. But few know how to steer them toward success as my rich dad did for me. Because the standard advice a parent says to a child is, "Go to school to get a job." Yet what they're advising their child to be with that advice is a *proletariat*—someone who sells their labor for money.

This is because an employee doesn't own the production.

All they do is trade time for money, hours for dollars, and help their boss (the employer) get wildly rich.

Yet, this is how it goes for most Americans.

They go to school, get a job, and live paycheck to paycheck.

Or, in many cases the child takes the advice of their parent and actually finds a *high-paying* job! They're no longer a prole. They've moved up the ladder and joined the *bourgeois* as a middle-class person.

This is when they become happy with material trappings such as a college education, house, and fancy cars. They're comfortable being comfortable, and spend most of their time keeping up with the Jones (who, by the way, are also scraping by just to maintain their image).

They're happy to drive past the slums, tenements, and dwellings of the proletariat, making sure their kids do not go to school with "those kids." Most of the bourgeois have high-paying jobs and many are self-employed specialists such as doctors and lawyers, or small business entrepreneurs.

But they don't own the *real estate* or the *production*.

These people still work for money on somebody else's land and although getting a high-paying job is better than being a prole, they still aren't ever free. It's not until you own the land and call all the shots that you've made it. It's not until you can truly dictate what your day will look like that you're free.

And my friend, trust me, the best way to be able to do whatever you want to do whenever you want to do it is through *real estate*.

Why Rich Dad Wanted Me to Learn From Seminars

Rich dad said, "Your future is created by what you do today, not tomorrow." In other words, what you are doing today is your future.

There was a time, long ago, when my wife Kim and I had no money. In fact we were nearly one million dollars in debt do to my Velcro-wallet business. We were living out of our car and then in a friend's basements for a few months while we got back on our feet.

We did not take jobs even in this dark time. The reason Kim and I did not take jobs, even though we were strapped for cash, was because we had no plans on being employees in the future. Instead we spent our time in seminars learning either how to build a business or invest in real estate.

Even though we had no money, each and every day we practiced building better businesses and investing in real estate. We were doing today what we planned on doing in the future. Today, we build businesses and invest in real estate. Tomorrow we will probably be building businesses and investing in real estate.

I have no plans on doing what my poor dad did after he retired, which was to look for jobs so he could supplement his Social Security income. He started his life preparing to look for a job, and he finished his life looking for a job. In these times there are millions of people my age doing the same thing my poor dad did, looking for a job to supplement their Social Security income. They will be doing tomorrow the same thing they are doing today.

Results Or Promotions.

My poor dad went back to school often. That is why he attended the University of Chicago, Northwestern, and Stanford University—all excellent, prestigious schools. My real dad would come back excited, enthusiastic, and expecting a promotion because he had invested his time going back to school.

My rich dad went to seminars. He said, "You go to school if you want to be a better employee or better professional person such as a doctor, lawyer, or accountant. If you don't care about degrees, promotions, or job security, then you go to seminars. Seminars are for people who want better financial results than a job promotion or increased job security."

I teach seminars rather than teach inside a school. Schools attract a different type of student than seminars do. For example, my wife, Kim, and I have an agreement that we go to at least two seminars a year together. We go together because we find that seminars, even bad ones, make our marriage, friendship, and business partnership stronger. Information or education has the power to bind people closer together by the common experience. It can also drive a wedge between them if they do not learn together.

Over the years, we have attended many seminars on marketing, sales, systems development, handling employees and, of course, investing.

We once attended a seminar on how to borrow money from the government to invest in low-income housing. The seminar cost only $85, was put on by the government, and we've made millions from what we learned. That is what I mean by people attending seminars for results rather than promotions.

For me, I would rather spend $5,000 and three days to learn how to make millions and possibly billions, rather than spend four years and $85,000 to learn how to work for $55,000 a year for the rest of my life. On top of that, that $55,000 is ordinary income which means its taxed at the highest level possible.

My First Real Estate Seminar

Late one night, as I prepared for an early morning flight that the Marine Air Station, an infomercial came on TV, enticing viewers to sign up for a real estate investment course. I dialed the number on the screen and signed up for a free preview to be held in a few days. That the free seminar, I heard exactly what I wanted to hear and paid $385 for a three- day course to be held in a few weeks. That the time, $385 was a fortune for a Marine Corps pilot whose flight pay was less than $900 gross a month. Like most people, I had a mortgage, car payment, and other expenses. My mind went crazy as I wondered if I was being smart or foolish. I wondered if I was being taken and if I would walk away with nothing.

That $385 turned out to be one of the best investments I have ever made. That course has made me multi-millions of dollars, over and over again, much of it tax-free. More important than the money is the impact that course has had on our lives. Investing in our education, through that course, is one of the reasons Kim and I were able to become financially free, Kim that 37 and me that 47.

In 1973, I did exactly what the instructor of the real estate course taught us to do. I spent weeks looking that different investments. That every real estate office, the real estate agents told me the same thing, “You cannot find those deals in Hawaii. Hawaii is too expensive.”

I was prepared for this closed-minded chatter from real estate agents because the course instructor had warned us, saying, “That is why they are real estate agents and not real estate investors. If they were investors, they would not need to be sales people.”

Agents take classes in classrooms from teachers. Investors learn from seminars and other investors.

After weeks of searching and hearing over and over, “You can't do that here. What you want does not exist,” I finally found a tiny real estate office on a back street of Waikiki and found the answers I had been searching for. When I said to the broker, “I'm looking for an investment property in a great area, low priced, very little to zero down, and something that has positive cash flow,” he smiled and said, “I have what you're looking for. In fact, I have nearly 35 of them.”

Three days later, I flew to the island of Maui, rented a car and drove 45 minutes to the property. Once there, I could not believe my eyes. The project was spectacular. It was across the street from a beautiful, isolated sandy beach, just like in the post cards of old Hawaii. The reason the prices were so good is because the entire property was in foreclosure. Then everything was for sale. Like a kid in a candy store, I went from unit to unit, looking for the one I wanted. Finally, I chose one. The price for any unit was $18,000. The terms: 10 percent down, or $1800, with the seller financing the balance.

The seller financing the balance meant I did not to have to qualify for a bank loan. It was everything all the other real estate brokers said did not exist, and it was on the island of Maui, near one of the most desirable resorts on the island.

Once I knew the property would generate cash flow, even with 100 percent financing, I pulled out my credit card, putting the $1,800 down payment on the card. I had none of my own money in the investment, and I still made money. Then, eventually, I bought a total of three of these properties. I would have bought more, but my credit card was that its limit.

About a year later, I sold the three properties for approximately $48,000 each and put nearly $90,000 in my pocket. Not a bad return on a $385 seminar and credit card down payments.

The seminar taught me how to invest. A classroom would have taught me all the reasons I could NOT invest. That is why rich dad wanted me to attend seminars.

Why A Students Work For C Students

It was during one exceedingly boring class that I remembered a very intense meeting my rich dad once had with his advisory team. As tempers flared and his team disagreed, my rich dad finally laid down the law and said,

"A business is not a democracy. I pay your salaries. Either you do what I ask, or look for a new job."

I believe I was about 16 years old at the time, and the exchange disturbed me. I'd never seen grown men and women argue so intensely or emotionally. I also remember many of his staff backing down once rich dad threatened to fire them if they failed to do their jobs.

He said, "All I ask of you is to do your jobs. I do not want your excuses. If you cannot do your job, look for a new job."

Once the meeting was over, rich dad took his son and me aside to make sure we were okay. It was then that I heard him say for the first time, "This is why 'A' students work for 'C' students. The 'A' students may have been smart in school, but they do not have the guts to start, own, and run their own business. They went to school to become specialists, only knowing the law or accounting or sales and marketing. *They know how to work for a paycheck, but they don't know how to build a business and make money.* They have brains, but lack guts. They are terrified of risk. If you don't pay them, they don't work. If they do extra work, they want overtime or time off. They want me to do things their way, but they are not willing to pay for their mistakes if they fail."

He added, "I have to pay for my mistakes as well as theirs. If the company fails, I am left with the mess, the debt, and the financial losses. They simply look for a new job. That is the primary difference between 'A' students and 'C' students."

He then told me, "People like your dad are 'A' students, people who do well in school but never leave school. So they become 'B' students, bureaucrats. They are people with responsibility who are terrified of risk. Most bureaucrats work for the government or other bureaucratic organizations, hiding in big corporations or organizations where office politics, laziness, and incompetence are tolerated. Most 'A' and 'B' students cannot survive in the B and I quadrants where managing risk and living or dying by the results of your decisions are everything."

Rich dad also criticized my poor dad for being the head of the teachers union.

Although he did not say much to me on that subject, he did not hide his feelings toward union members. One day, a group of his employees got together to unionize his hotel and restaurant operations.

He backed them down saying, "I'll shut down the business and all of you will lose your jobs if you unionize. I can start a new business and I don't need the money, but you need your jobs. I've been fair to you and your families. All I ask is for you to be fair to me and my family."

When the vote was taken, the union lost.

I know it feels like I'm picking on education. That is not entirely accurate. Rich dad agreed with my father that a college education would be good for me and he did not even rebuke the idea of me getting an MBA. What was important to rich dad is that i also receive education from investors and people who actually do what they teach in the real world. Very rarely is that person found in the education system.

As I sat in my MBA program classes, as an adult and a combat veteran, bored to tears, I better understood my rich dad's lessons. I realized my rich dad focused his life on his asset column by acquiring property and production. He was a true capitalist.

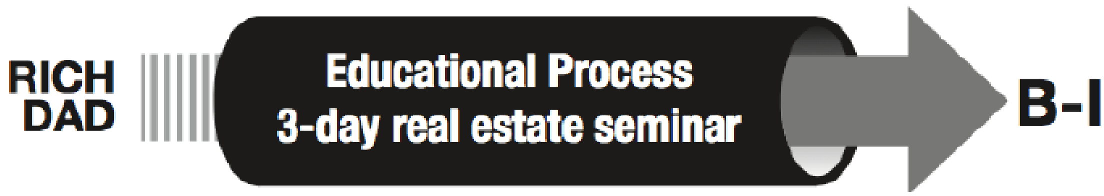
My poor dad and rich dad's employees, many of whom were 'A' and 'B' students, focused on job security and a steady paycheck. They had college degrees and jobs, but owned nothing. They had no property or production. It's not surprising they needed security, benefits, and a pension plan.

Sitting in the MBA program, listening to my instructors drone on from textbooks and theory rather than real-life business experience, I realized I was learning from teachers I did not respect. That's not to say they weren't good people. Most teachers are like my poor dad— very good people dedicated to their profession. The problem with my MBA instructors was they were "A" students who lived in the E and S quadrants. I wanted to learn from teachers who lived in the B and I quadrants.

I dropped out of the MBA program after three months, the only time I ever dropped out of school. Not surprisingly, poor dad was disappointed; my rich dad wasn't. I'm pretty sure he knew this would happen from the start, but needed me to learn the lesson of classroom vs. seminar first hand.

I didn't miss a beat in continuing my real-world education. I had signed up for a three-day real estate investment course on my rich dad's suggestion. I recall challenging his suggestion and saying, "But I'm not interested in real estate." I also reminded him I didn't have much money. Rich dad just smiled and said, "That's why you need to take a course in real estate investing. Real estate is not about property. Real estate is about debt and using OPM, Other People's Money, to get rich."

It finally dawned on me that my rich dad was, once again, steering me to the education I was seeking, education for life in the B and I quadrants. The simple diagrams below illustrate this point.



Education is a process.

If you want to become a doctor, you go to medical school. If you want to become a lawyer, you go to law school. If you want to become a capitalist in the B and I quadrants, you need to choose your teachers, your classrooms, and your educational process carefully.

In 1974, while still flying for the Marine Corps, I began applying to IBM and Xerox because they had the best sales and management training programs. Just before completing my contract with the Marine Corps, I was accepted into the Xerox Corporation's training program and was own to their training headquarters in Leesburg, Virginia. Xerox was another step in connecting the dots, the educational process, to develop my neural pathways for the B and I quadrants.

At Xerox, I struggled to overcome my shyness, knocking on doors and learning to handle objections and rejection in order to sell Xerox copiers. Finally, after two years, selling started to come more naturally, an integral part of who I was becoming... a capitalist in the B and I quadrants.

Starting Early Is a Head Start

Now, of course, if not for my rich dad's teaching I might have followed in my poor dad's footsteps—earning an MBA, climbing the corporate ladder, and competing with "A" and "B" students, rather than hiring them as employees who would work for me.

Rather than working to acquire property and production - assets as my rich dad called them - I might still be working for a paycheck, paying higher and higher taxes, and praying I wouldn't outlive the money in my retirement account.

I want to repeat an important point: I am very pro-education— just not the education taught in traditional schools. If you want your child to be an employee in the E quadrant, or a doctor or lawyer in the S quadrant, traditional education is needed. If you want your child to have every opportunity for success open to them, then they must have every opportunity for education. And in many cases that means a departure from the traditional, into less conventional, real-world learning environments and classrooms.

The important lesson I've learned is:

Each quadrant is a different classroom... requiring different teachers.

Students often ask me, "What if I cannot get a job with a company like Xerox or IBM? How do I get my own sales training and experience?"

I'll tell you what I tell them - sales training and experience is vital for anyone wanting to be an entrepreneur, especially in the B and I quadrants. There are many ways to get sales training.

I suggest that individuals look at network marketing companies for the training they offer. Many network marketing companies provide excellent personal development, fear management, rejection management, and sales training—especially for people who are afraid of selling or are new to sales.

The best thing about network marketing companies is that they will not fire you if you do not perform, as Xerox would have fired me if I had failed to sell its products and services. It did not matter how long I worked for Xerox. Then every salesperson knew they were only one or two months away from being fired, if they failed to sell.

Another concern new real estate investors often have is a lack of money.

That is why I recommend taking real estate investment courses. If you truly understand the skill sets in the B and I quadrants, you'll see you're not supposed to use your own money. Your job is to learn to raise capital using OPM, Other People's Money (in this case: your bank's), not using your money.

Simply said, capitalists know how to use debt to make them rich. It is known as OPM, Other People's Money.

Becoming a capitalist is hard work and relatively few make it.

That is why investing in your education—yours and your child's—is crucial, especially today. People who are not actively studying and learning, regardless of which quadrant they live and work in, are falling behind rapidly.

When you read the stories of entrepreneurs—great capitalists such as Steve Jobs, Bill Gates, and Mark Zuckerberg—they began their path to capitalism and educational process early on in their lives.

So did The Beatles and many professional athletes.

This is not to say your child must know their professional calling while in school. What I am saying is, regardless of their profession of choice, all children will be dealing with money. Why not begin their financial education early so they can better choose which quadrant is the best quadrant, the best classroom, for them?

My rich dad prepared his son and me for the real world of money. Most schools do not. This is why a parent's love, patience, and guidance are essential, and why lessons about money need to be a part of what a child learns, from an early age, at home.

Fast, Low-Cost, High-Impact Education

There is one more source - other than seminars - of fast, low-cost, high-impact education I use on a regular basis. In 1974 when I left the Marine Corps and knew I was not going to stay in the E quadrant like my poor dad, I began listening to recordings from some of the great business, motivation, and leadership masters in the world. I still remember buying Lead the Field by Earl Nightingale and listening to that tape program over and over as I drove around my sales territory, planning my escape from the E quadrant and the corporate world. In fact I still listen to that program about once a year while at the gym or in my car.

When people ask me "How do I find a mentor?" I often say, "Buy an audio book. In those libraries are some of the greatest mentors of all time." As rich dad often said, "The truly rich get rich at home and in their spare time." He also said, "It is not your boss's job to make you rich. That is your job."

Through reading and listening to books I have learned more, made more money, found new inspiration to carry on, came up with new ideas, or discovered new ways of doing things just while driving my car, working out in the gym, or going for a walk. The collection of masters available is innumerable, yet for less than a hundred dollars you can spend as much personal time as you want with some of the great teachers and masters of the world. All you have to do is rewind, and they will repeat exactly what you want to hear.

I never received a college degree from these tapes, but I did find financial freedom and, most importantly, the confidence to be true to who I am.

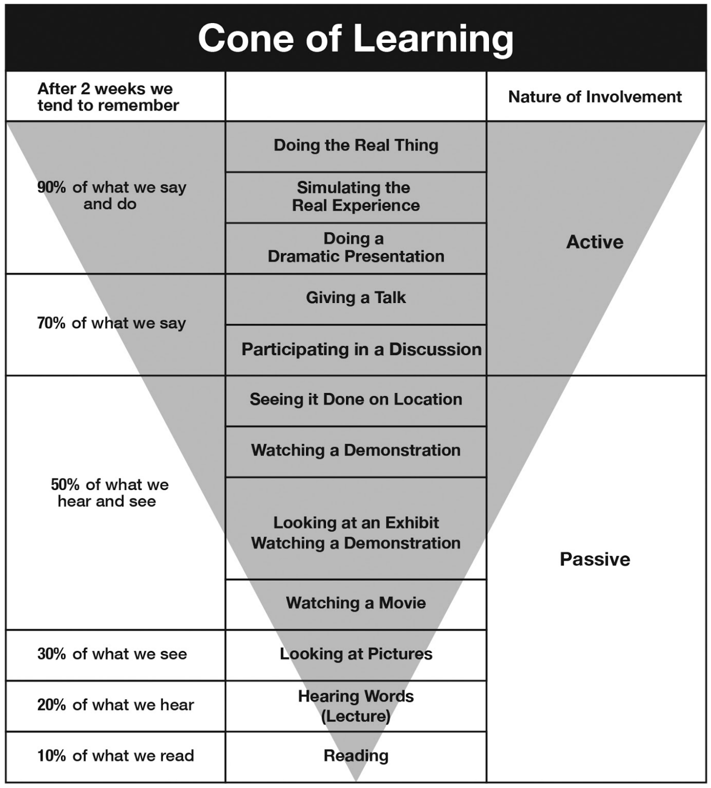
Nowadays, in the Information Age, and the time of the internet, many people find valuable lessons and courses online. Personally, I am paralyzed with technology, but at the Rich Dad Company we create online courses to help students who learn best through their phone or computer.

Learning By Doing

A lot of people like to read or listen, but it's proven that you learn better by simulating than any other method of education.

A number of years ago, Arizona State University came by to evaluate the value of our CASHFLOW game. Could it really be used as a teaching tool? They found out it was a great tool. Here's why.

Below, you'll see a diagram called the Cone of Learning. It was created in 1969 by a man named Professor Dale.



Source: Cone of Learning adapted from Dale, (1969)

Starting at the top, you'll see many people don't do well in school because the worst way to learn is by reading. I didn't do well in school, because I'm a very poor reader.

The second worst way of learning is hearing words or lectures, so kids like me in school just don't do well, because I fidget a lot, I don't like lecture, and I'm a poor reader.

Below that, it says you can watch a movie or watch a demonstration. This is all kind of passive learning. This is not the way I - or many people - learn.

Now, the best way to learn is do the real thing. For instance, if you want to invest in real estate, the best thing you can do is go do it. If you want to play the stock market, you've got to do it.

The second best thing, though, is simulating the real experience. What Arizona State found was a CASHFLOW game was as close to a simulation of the real thing as you could get. The game is designed for you to play over and over and over again to make mistakes, to learn, to correct, to adjust your brain.

That's why I love games and I'm really glad to find out way back in 1969 Professor Dale found out the same thing I already knew - playing games and having fun is one of the best ways you can learn.

Whether or not you did well in school, just by playing the game, you get smarter and smarter. You learn the vocabulary, learn how numbers work, and so on. This is a big part of the Rich Dad experience. Once you understand the game and our books, then you go do the real thing.

The reason most people get hammered under the real market out there is because they jump in, they have no experience, they do the real thing, and they lose all their money and they wonder what happens and they've turned their money over to somebody they pay to lose their money, because most financial advisors are not really advisors. They're really salesmen.

You can circumvent this by training your brain before this ever happens to you. If you want to get rich, practice, play the game over and over and over again and soon you'll start to think like a rich man.

The Future Of Education

A couple years ago, I saw a wonderful TED Talk by Gabe Zichermann called "Changing the Game in Education."

In the talk, Zichermann talks about how the modern education system is fundamentally opposed to our nature as humans. Asking us to sit down and pay attention does very little for our education, when in reality we learn more by trying, making mistakes, and achieving.

Experiencing the chemical benefits of the pleasure we feel when dopamine is released through our achievements helps us remember and learn far more efficiently.

He then goes on to make the case for why gamification is the future of education-including an amazing example of a teacher using Monopoly at a school in California's Inland Empire to teach kids about money, among other things. The result: a jump of 40 kids in the top rankings of the California Math Test, up from less than 10 at the start of the program.

This is why, even though we have books and seminars, we've always said the best way to learn how to invest is to play our financial education board game, CASHFLOW. We've seen that those who devote themselves to mastering this game, in addition to reading and hearing great talks, go on to much greater success in investing.

Perhaps this is because as Dan Schwartz, who runs the AAA Lab, "a technology and learning lab" at Stanford, has discovered , "one of the best negative predictors of performance was the act of walking away after failure." Games allow us to keep coming back to the table after we've failed, thereby improving our performance significantly over time.

Less Talk, More Action

In 1950, a nun who was a history and geography teacher in Calcutta was called on to help the poor and to live among them. Instead of just talking about caring for the poor, she chose to say very little and helped the poor with her actions, not just her words.

Because of this, when she did speak, people listened.

She had this to say about the difference between words and actions: "There should be less talk. A preaching point is not a meeting point. There should be more action on your part."

At Rich Dad, we made a conscious choice to incorporate games into our education methods because they require more action than a lecture. As Mother Teresa said, "A preaching point is not a meeting point." Our games are meeting points.

Games provide a social interaction for learning and helping someone else learn. When it comes to investing, there are too many people trying to teach by preaching. We all know there are certain things that are not best learned by simply reading and listening. Some things require action to be learned, and games provide this elementary action step to learning.

Confucius once said: "I hear and I forget. I see and I remember. I do and I understand."
Ultimately, we believe games create more understanding. The more understanding people have, the more they can see the other side of the coin. Instead of seeing fear and doubt, the players begin to see opportunities they never saw before because their understanding increases each time they play the game.

There are many stories of people who have played our games and have had their lives suddenly changed. They have gained a new understanding about money and investing, an understanding that pushed out some old thoughts and gave them new possibilities for their lives.

A World Of Opportunity

Again, rich dad taught me to be a business owner and investor by playing the game of Monopoly. He was able to teach his son and me so much more after the game was over when we visited his business and real estate.

I wanted to create educational games that taught the same fundamental and technical investing skills that rich dad taught me, far beyond what is taught in Monopoly. As rich dad said, "The ability to manage cash flow and to read financial statements is fundamental to success on the B and I side of the CASHFLOW Quadrant."

That is why we continue to develop new games and apps taking advantage of new technologies. Each game teaches new skills, opens up your mind to a world of opportunity, and drills home the lessons of cash flow. With repetition, those lessons will become ingrained in your psyche and how you approach your financial future.

Whether he was having me work in his store for free, learning the lessons of Monopoly, visiting his businesses and properties, or sitting in on his meetings with his advisors, rich dad taught by doing. He didn't stand on the sidelines and neither did I (and neither should you).

To make this work, you have to *do*.

CHAPTER 7:

Rich Dad Differences in Real Estate

Before I go any further I need to discuss two things that people always try to avoid, debt and taxes. Most people believe those two things are their biggest financial hurdles.

Rich dad taught me to see them differently. In short, *good* debt is the shortcut to wealth and taxes are simply the guidelines or playbook the government provides to tell you what they want you to invest in.

Since these two things will be a part of every strategy and the entirety of this book, I took the time to dig in a little deeper about the ways to use debt. I've also asked two of my advisor to explain the Rich Dad approach to taxes, especially with how they pertain to taxes.

Use Debt to Grow

Debt And Monopoly Part I

Rich dad always said debt was like a loaded gun. Pointed in the right direction it could help you achieve some amazing goals - this is an analogy, I am not endorsing bank robbing. But pointed in the wrong direction and debt, like a loaded gun, can create serious destruction.

One Saturday Monopoly game rich dad decided to teach us about the power and destruction of debt. Mike and I used to always fight over the race car. Normally we would roll the die and the highest number would get the race car. This week it was different though.

As we started to roll the die, rich dad stopped us. Today it's going to be different. Anyone who buys a fancy car BEFORE they are rich must use debt to do so. Which one of you wants to go into debt for the race car? Mike paused. He knew his dad and he knew it was a trap.

I jumped in with both feet. "You always use debt" I said. "I'll do it!"

Rich dad smiled. "Good. This car costs $300."

"If I pay you $300, then I won't have much left to buy properties." I wined.

"Don't worry Robert. I only need $50 now and another $50 every time you pass GO."

"Oh." I said relieved. I get $200 every time I pass GO. I would still get $150.

"DEAL!" I Exclaimed feeling victorious over Mike. I got the race car!

You probably can guess but I lost that game of Monopoly in record time. I never had the money to buy the properties I needed and that meant Mike and rich dad got all the properties. I was bled dry and bankrupt in no time.

As I lost my last dollar I dropped my head in shame.

"Don't worry Robert," rich dad said. You are not done yet. You can sell your race car to the bank.

"I can?!?' I suddenly knew i was going to make a sudden comeback and beat Mike.

"Of course" said rich dad.

"The bank will buy the car back for $100."

I thought I heard rich dad wrong. I had already paid the bank well over $450 from all the payments I made by passing GO.

"Whenever you buy something new, as soon as you drive it or use it, it becomes 'used' and loses much of its value" rich dad said.

I think rich dad saw the expression on my face. I was holding back tears. I felt stupid and foolish.

"Don't be upset Robert" rich dad said kindly.

"Aren't you glad you learned this lesson with fake money instead of real money? And you are not the only one who learned this lesson. I saw Mike's eye earlier. He wanted to buy that car just as bad as you did."

"That's true. I did. I was just sure dad had some trick up his sleeve so I hesitated."

I felt a little less stupid after Mike said that.

"There are two very important lessons about debt I wanted to teach you. Do you know what they are?"

Mike guessed first. "Well we know debt is good, but I think we learned that it can be bad too."

"That is pretty good Mike, but I would not say it is 'bad', I would say it is dangerous and can be used in bad ways"

"Like buying cars instead of real estate" I piped in.

"Like buying liabilities instead of assets" rich dad gently corrected. "I do not like to buy cars and other liabilities. I like to buy cash flowing assets and let them buy the cars and liabilities. Its a matter of priority. Buy the assets first, then when the assets are making enough money, the money from the asset will buy you the fancy cars."

"Any guess on the second lesson?"

Neither Mike or I said anything. Not because we were beaten down, but we truly had no idea.

Rich dad started the conversation. "Robert, why did you want the race car so badly?"

"It just looks cool" I said. "I hate going around with that stupid hat."

"Is that why you wanted it too Mike?" rich dad asked.

Mike nodded, "all the other ones are… kind of boring and no fun."

"Have you ever heard the phrase "keeping up with the Jones?" rich dad asked us both.

"Its when people buy things to give the *impression* of being wealthier than they are. They are buying liabilities to *look* rich and make their neighbors jealous."

"That is basically what I just did. I wanted to look cooler than Mike so I was willing to buy the race car no matter what it cost."

"Exactly" said rich dad. "Next time we play will you buy the race car again?"

"NO!!!" both Mike and I shouted with the energetic release of knowing the answer and understanding the lesson. It felt so good to learn such a huge lesson in such a safe, fun way.

"Great!" said rich dad. "Next week we are going to play with debt again, but we'll learn the good side of using debt and how debt can make us wealthy."

Poor People's Relationship With Debt

When most people hear the word "debt," they cringe.

They think about their unpaid student loans and credit card bills, and they think of collection agencies harassing them. This is because most people, especially poor people, only have experience with bad debt. This experience both leads them to shy away from debt, and to tell their loved ones to do the same.

Most poor people fall into two categories with their beliefs about debt, and a lot of that comes down to how they were raised. Some poor people were raised to think debt is something that you can just rack up without consequences. This leads to catastrophic results. Other poor people are taught that debt is bad, and to stay as far away from it as possible. While this doesn't put them in the same danger as abusing debt, it does ruin their chances of using leverage to become rich and successful.

To properly use debt, you need to understand the differences between good debt and bad debt, and you need to understand the difference between how poor people look at debt, and how the rich look at debt. Once you understand debt in these ways, you'll be able to leverage debt properly, and you'll be able to use OPM to reach your financial, business and investment goals.

Let's first look at the poor, and consequently, bad debt.

The Poor and Bad Debt

The poor have a misunderstanding of debt that not only keeps them poor, but actually makes them even poorer. Not only do they misunderstand, they also use credit to purchase liabilities, like cars, clothing, phones and more.

Many poor people are enticed into getting credit cards with the idea that they will be able to purchase whatever they want, and they can simply take their time to pay it down. With "cashback" rewards and other incentives, poor people are suckered into thinking that they are actually earning money by using their credit cards, and this encourages them to take out more and higher lines of credit.

They are also pressured by stores to get credit cards to purchase items that they can't afford, and these stores often give out credit cards with some of the highest interest rates around. Still, they sell the poor on the idea that they need that big screen TV, couch or new dress today, and that the only way to get it is to apply for a store credit card.

Then the bill comes, and most poor people don't know what to do. They freeze up or ignore the bill, which destroys their credit and causes the credit card companies to send collectors after them. After daily phone calls at all hours, bills piling up and the threat of repossession, poor people realize that they are misusing credit, which causes them to fear it.

When you use credit to purchase liabilities, you are only racking up bad debt. Most poor people don't understand this and when they learn it, they learn it the hard way.

Once poor people finally pay down their loans from the bad debt that they accrued, most of them give up on debt altogether. They avoid OPM, and they teach their kids to avoid it as well. This is sad, because their fear of bad debt also keeps them away from good debt, and good debt is part of how the rich get richer.

The Rich and Good Debt

Debt And Monopoly Part II

Just as rich dad promised, we learned a new lesson about debt the following week of our Monopoly game.

"Does anyone want to buy the race car this week?"

"No!" Mike and I shouted in unison.

"Great. But remember, there is such thing as good debt. And good debt is what build wealth."

We had already known this. We watched rich dad get more and more debt regularly as we sat in on his advisor meetings.

"Today I'm going to show you how to use good debt playing Monopoly."

Rich dad went on to change the rules. Instead of paying for the whole price of a property, he allowed us to only pay a down-payment of 20%. He made us keep track of how much we still owed the bank on a sheet of paper. Every time someone landed on our property we would give half the money to the bank and keep half ourself. He also did two other big changes. One, he increased the price of the properties by 50%. This was to represent the interest we needed to pay back the bank for our loans. Second, he made us start the game with half as much money as usual.

"What?!?" Mike and I exclaimed. "Why?" we whined.

As usual, rich dad would not explain but asked us questions.

What do I always tell you about making money?

"It does not take money to make money?" Mike responded.

"Yes! And today you are going to see that for yourself. Let's play!"

After playing for a while Mike exclaimed that he had paid off in full his first property. He no longer owed the bank! Rich dad paused and then asked, "did you pay off the loan?"

Mike, knowing that the answer was 'yes', but also knowing that somehow it was not the answer from rich dad's tone said, "no???"

"Are you asking me or telling me?" Rich dad responded.

"Asking" said Mike after a very long pause.

"What do you think Robert?" asked rich dad. I of course thought Mike did and, like Mike, sensed that was not the correct answer. Suddenly I knew the answer!

"You and I paid off the loan. Every time we landed on the property and paid rent WE paid off Mike's loan."

Mike's face turned from one of contemplation to realization.

"That's right Robert. What makes 'good debt' so good is the fact that you are not the one paying it off. Someone else does, and you get the asset."

That is why good debt makes you wealthy. The more good debt you get, the more assets you'll get.

Freedom Through Debt

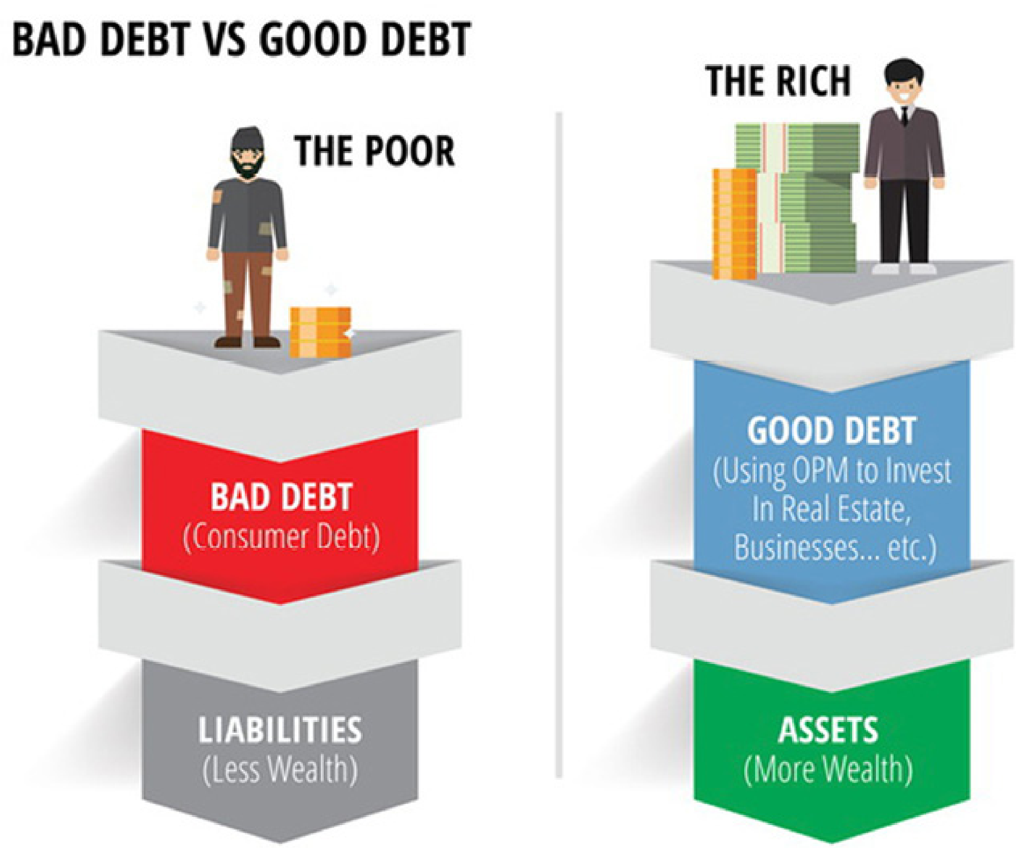
Unlike the poor that become trapped by their debt, the rich use their debt to liberate them. Good debt allows the rich to grow richer, because good debt leverages OPM in a way that benefits both the debtor and the investor or business owner.

Also unlike the poor, the rich use debt to purchase assets, instead of liabilities. Where the purchases of the poor continue to make them poorer because they depreciate in value, the purchases of the rich allow them to become richer. They spend their money purchasing real estate, businesses and other investments that will turn a profit, and then they use some of that profit to put a down payment on more good debt.

When my wife Kim purchased her first piece of real estate, she put down $5,000 and she borrowed $40,000. Since then, we have borrowed and invested millions of dollars, and guess what? We've become even richer.

The rich also know that the debt that they take on isn't for them to repay. What I mean by this is that the rich will borrow money and will pay the money back with OPM. That's right—they use OPM to make money, then they take the money that they made from people and pay back the money they borrowed.

Let's take real estate as a simple example. Let's say you bought a piece of real estate using the bank's money. Then, you rented the property out. You charged your renter enough to cover expenses, insurance, the mortgage and a healthy profit. You have now used OPM to pay back the money that you borrowed from a different set of other people.



The poor and middle class, on the other hand, take on debt and pay it out of their own pocket. They may take a loan from a bank to buy a car or a home, then they are forced to pay it back with their own income. Doing this will not make you rich.

Debt and Income Tax

Here's the other thing that the rich realize about debt—it is income tax-free. Now, this isn't to say that it is tax-free, you still have to pay taxes on whatever you are purchasing with OPM. Still, you don't have to use your own money, which has been taxed, in order to make a purchase.

Let's say that you made $20,000, and for simplicity, you had to pay 25% of that in taxes. That leaves you with $5,000 less, so you actually only have $15,000. If you wanted to invest your $20,000, you'd only be able to invest $15,000 max.

Now, let's say that you borrowed $20,000. You can invest 100% of this $20,000, because it isn't your money. You can't be taxed on it.

Again, this doesn't mean that your investment will have no taxes attached to it. If you took out a car loan for $8,000, and you went to buy a car, you couldn't buy an $8,000 car with that loan - you still have to pay sales tax. But, you have access to $8,000, whereas if you were to use your own money with a 25% tax rate, you'd only have access to $6,000.

This is another major reason that the rich use OPM, and how they avoid paying taxes on many of their purchases.

Be Careful with Debt

Whether you are taking on good debt or bad debt, you are still taking on debt. Because of this, I want to warn you to be careful when taking on debt.

Even if you'd convinced the banks that you know what you're doing with the money, you still need to be certain deep down that you actually know what you are doing, and that you aren't taking a huge risk without thinking it through.

I believe in using debt to make myself richer, but I don't encourage people to use debt just for the sake of using it. Think things through first, and see how you can leverage debt to make yourself richer, instead of putting yourself in major danger. Also, make sure you understand the difference between an asset and a liability before you take out any loans.

To become richer, learn to leverage OPM properly, and to spend it wisely.

Tax Advantages to Real Estate by Rich Dad Advisors Garrett Sutton & Tom Wheelwright

As the years went on and my base of education grew, I came to better understand the bigger picture of the world of investing. Rich dad said, "If you want to be a sophisticated investor, you must train your mind to see what your eyes cannot see."

What my eyes could not see were the legal and tax advantages that real estate investing offers the more informed investor. In other words, there is far more to real estate than dirt, sticks, and bricks.

So, in this lesson written by my advisor Garrett Sutton, he'll go into the real reasons why the rich invest in real estate by taking you into the world of real estate investing that the average investor rarely sees.

Today I make my money from all three asset classes: businesses, real estate, and paper assets.

But I hold the bulk of my wealth in real estate. I am able to magnify my wealth using the advantages that real estate offers the sophisticated investor.

There have been challenges for real estate investors in the recent past. But if you learn the ins and outs of real estate investing, you can make money in real estate whether the market is going up, down, or sideways. That is why my rich dad preferred investing for cash flow instead of capital gains.

As long as your property is cash-flow positive, you can ride out a downturn in the real estate market. The flippers and capital-gains buyers who are left holding properties for resale in a plummeting market are the ones who will be hurt the most.

You also need to surround yourself with good advisors.

As a real estate investor you must seek tax and legal advice from professionals, which is why Garrett wrote this lesson. I do not know all of the details of the tax and legal advantages he describes—but I am glad that he, as my advisor, does.

If you are ready to become a sophisticated real estate investor, find out how to use tax, legal, and other little-known advantages that investing in real estate offers, and how to find your own team of advisors, this lesson is for you.

Now, this lesson is just a glimpse at what's out there with regard to the tax loopholes in real estate. Just a tiny picture. If you want to see the full spectrum, I highly encourage you to set up a meeting with a Rich Dad Advisor and/or local real estate accountant in your area.

Because what I want you to see here is what's possible - not everything, but just enough to show you why real estate really is an amazing investment option for anyone who wants to get rich.

Tax Advantages of Real Estate

Garrett Sutton, Esq.

If the word "taxes" strikes terror in your heart, you're going to want to pay careful attention to this Bonus Lesson. I'm going to share some tips for making sense of a property's financials, turning depreciation to your benefit, and capitalizing on the tax code by considering making real estate your business.

When you educate yourself about real estate investing and make it a priority to learn the ins and outs and the not so hidden loopholes, you might just find that when you hear the word "taxes," you'll simply smile to yourself as you wonder what all the fuss was about.

I want you to remember this key concept: Real estate investing is good for the economy.

This is an important mantra for you.

It means that the government (yes, even the IRS) wants you to invest in real estate. Your investment provides housing to a large portion of the population, it promotes continued development and community improvement, and, through construction, rehabilitation, maintenance, and management, it provides jobs for thousands of people.

In short, the government not only supports investment, it needs it to stimulate and grow the economy.

I emphasize this point to explain why the tax code favors investors, and why real estate investment can be such a financial boon for you. It's truly a win-win: You can earn passive income, while also saving money on your taxes.

But in order to achieve such positive results, the investment has to look good on paper.

- How do you know what to look for?
- What will the numbers show?
- And what are the tax strategies used by successful investors that you can put into practice?

That's what I'll touch on here.

Now, it's important to note that there's a tax on net investment income.

If you have an adjusted gross income (at this writing) of $200,000 as a single person or $250,000 as a married couple you get to pay a Medicare surtax of 3.8% on gains, interest, dividends, royalties and passive rental income.

So when we talk about a 20% capital gains rate, know that for upper income earners it is really a 23.8% rate. Please remember this in all your calculations.

Of course, you shouldn't make any major decisions without consulting your tax accountant, and this section certainly won't take the place of having an accountant that keeps his or her eye on your particular financial picture.

But you'll know what to ask and what's possible, and hopefully these tax strategies can help your own portfolio grow. The government has opened up tax loopholes to encourage all American citizens to consider real estate investing. Not one person is excluded from these rules.

Whether you decide to take advantage of them or not is up to you.

Analyzing The Numbers

Unfortunately, there's no crystal ball or magic wand that can reveal to you whether a property will earn you a lot of money. If such a tool were available, you wouldn't be reading this book, and everyone would be wealthy.

But even without a crystal ball, you have a few tools that, if examined carefully, can at least provide an indication as to which way the wind is blowing for any property you're considering.

The first of these tools is called a pro forma.

The Latin term pro forma, literally translated, means "as if." (Or, as real estate veterans like to think of it, "As if you expect me to believe those numbers!")

It's not an encouraging name for a document that is supposed to present all the correct information about a prospective property. But nonetheless, a pro forma provides details at a glance about a property's selling price, operating costs, utility charges, property taxes, repairs, insurance, and more.

It also offers projections of the property's future value and potential income if at full occupancy.

However, because it's developed by the seller and the seller's agent, based on their idea of what prospective buyers want to see, it could be slightly exaggerated at best, and pure fantasy at worst.

It's an important document that provides a starting point for your analysis and determines whether you're even interested in pursuing the property, but it's by no means gospel in terms of making a real estate purchase.

This Is Where Your Own Due Diligence Plays A Key Role.

You'll need to draw upon your own experience and knowledge about the real estate market in your area, as well as the expertise of your team of advisors and accountant, who can shed light on aspects of the prospective property and community as well as on your own financial picture.

Once you've determined that you want to sign a contract on a property, you'll be given access to the actual financial figures (usually referred to as "the financials") on a property. Typically, the language a buyer will use when reviewing a property's financials will say something like this:

"This offer shall be contingent upon Buyer's complete review and acceptance of the financial records associated with the subject property."

So if the financials aren't to your liking the contingency is a loophole allowing you to escape the deal. Upon receiving the financials, you're going to look at the following:

- Selling prices of comparable properties in the area ("comps").
- Rents on similar properties in that area.
- Number of rentals in the area. (Is the market saturated? Is there a market for rentals here?)
- Utility bills for the property.
- Property tax bills.
- Recent expenses for repairs on the property.

Additionally, due diligence on any purchase must include a building inspection, which will reveal the actual condition of the property. Will you need to make major repairs, and if so, when? Can you do any of them yourself, or will it involve hiring outside help?

Will you need to hire maintenance help on a contract basis, for things like landscaping, etc.? Do you have enough cash reserves to cover such costs? All of this information will reveal whether the asking price is fair, or whether you need to ask for a bit of a price reduction (a "haircut") to close the deal.

In addition, you'll need to figure out the actual debt involved in taking a loan on the property (principal plus interest). And don't forget that your property might remain vacant for a period of time after you purchase it.

It may be unrealistic to expect to collect money from day one. Are you prepared to weather such a vacancy with your cash reserves?

All of this analysis, when taken in combination with the pro forma and the actual financials, will give you a clear picture of the potential risks and returns associated with the investment… if, indeed, it actually is an investment at all.

How A Real Estate Purchase Affects Your Financials

If the property appears to be a good investment, one that will produce positive returns, then it's time to think about the impact this purchase will have on your overall financial picture.

The property's positive cash flow will only be part of your cash-on-cash return. So I want you to see an example of how this works which involves a purchase of a five unit apartment building for $450,000 with 20% down.

The IRS considers your rental property as a business, and gives you several deductions. One is the payment you make on the interest (but not the principal) of your debt service. In addition, there are the "phantom deductions"—the "passive loss" from component depreciation and from building depreciation, which are computed at an annual rate.

So after you take your rental income (five units at $900 per month or $54,000 per year) and subtract operating expenses ($19,459), you also subtract the interest payments ($15,888) on debt service, and you subtract the component and building depreciation ($15,000 and $10,909, respectively).

You multiply this "paper loss" ($7,256) by your tax rate (35 percent), and determine your tax savings ($2,540).

You add the tax savings ($2,540) to your net cash flow from the property before taxes ($7,200) and come up with your true cash-on-cash return: $9,740, or 11 percent. Your true cash-on-cash return will show you how good (or not so good) a particular real estate investment will be for you.

In this case, the investor put down twenty percent of the $450,000 purchase price of the property. So that $90,000 investment yielded a cash-on-cash return of nearly 11 percent.

Obviously, real estate enjoys a distinct tax advantage over the stock market. If your projected paper loss in a rental property is $7,256, you can claim $2,540 in tax savings. But if you lost the same $7,256 in the stock market (and it would be a true drop in value, not a paper loss), you would only be able to claim the maximum for a capital loss—$3,000—on your annual tax return.

To claim the entire loss would take you three years.

By now you've learned that passive income, earned from such sources as rentals or stock, is superior to earned income. Earned income is earned because you had to work for it, and second, earned income is taxed at the IRS' highest rate of all income (it could reach more than 50 percent in some cases, when you consider payroll taxes). But for a rental such as the example above, the passive income can actually come to you tax-free, thanks to the write-offs from depreciation.

Our example showed a $7,200 positive cash flow that was not taxed, because the depreciation eradicated that income on paper.

This is why it's critical to determine your depreciation on a property as part of assessing whether or not to invest in it.

And this is just ONE of the many tax advantages of real estate!

Calculating Depreciation

The concept of depreciation is one that warrants a thorough discussion.

This is because it has a tremendous impact on your cash flow and the overall financial benefits of a real estate investment. When we talk about real estate investment, there are four types of property we are referring to:

- Land, which cannot depreciate (at least, not on paper),
- Land improvements, such as sidewalks or landscaping,
- Personal property, which refers to those items that can be removed without harming or affecting the structure's operation and maintenance, such as furniture or large appliances, and
- Buildings or structures on the land.

Though land cannot depreciate, improvements made to it, as well as all other types of property, have relatively short lifespans, and therefore are subject to depreciation.

The U.S. Internal Revenue Service (IRS) defines depreciation as "an income tax deduction that allows a taxpayer to recover the cost or other basis of certain property. It is an annual allowance for the wear and tear, deterioration, or obsolescence of the property."

Included within this general definition would be, of course, the normal wear and tear that comes with regular use of a piece of property.

But it also includes physical deterioration that comes from weather and the elements, lack of regular maintenance, or damage that may occur from natural processes, such as pest infestations or dry rot. "Obsolescence" refers both to features of the property that may be inadequate, outdated, or lacking in modern equipment or functionality, or to a property that may have been subject to economic restrictions, such as zoning restrictions or simple changes in supply and demand as a result of economic conditions or market changes.

The federal tax code designates items of personal property with a "class life" for each item, which is generally either five or seven years. While desks and fax machines may be considered seven-year items, computers, furniture, and even carpeting are considered five-year items; and you'll need your tax accountant to determine what items in your possession fall into which category and what your rate of depreciation will be for them—it's usually accelerated for the first few years.

Personal property's depreciation rate is better than that for building depreciation, which the IRS has assigned in a seemingly arbitrary fashion to be a 27.5-year period for residential rental property and a 39-year period for commercial real property.

That is, unless you apply cost segregation.

The Magic of Cost Segregation

Cost segregation is an important component of any discussion on depreciation, and is an extremely important tool in enhancing the value of any real estate investment. This is why I have asked Tom Wheelwright, CPA, a Rich Dad Advisor and author of Tax-Free Wealth: How to Build Massive Wealth by Permanently Lowering Your Taxes, to share his insights about cost segregation with you here:

Cost Segregation

Tom Wheelwright, CPA

In my book, Tax-Free Wealth, I spend an entire chapter explaining the "magic" of depreciation. Why is it magic? Because this is a deduction that the IRS gives to you without requiring you to put in any cash.

Your property can rise in value and you still get a deduction for depreciation. Of course, depreciation is simply a deduction for the cost of a building and its contents over a period of time.

The idea in the tax law is that you will have wear and tear on the building, so you should be able to deduct the cost of the building as that wear and tear occurs.

Part of the magic comes because you don't have to pay for all of the building. The bank will pay for 80 percent of it. And your tenants pay the bank with their rent. Even though the bank is paying for most of the building, you get 100 percent of the depreciation deduction. In essence, you get the bank's depreciation.

Pretty cool deal, huh?

Well, it gets even better with a cost segregation. While you may get a deduction for depreciation equal to anywhere from 2.5 to 3.6 percent for the cost of the building each year, you can get an even higher depreciation deduction if you do a cost segregation. So let's talk about what a cost segregation is, and how you do it.

Think about what you actually purchased when you bought your building. You purchased land and a building, of course. But you also purchased the contents of the building, such as the lighting, flooring, cabinetry and window coverings, as well as the land improvements. Your land improvements include the landscaping, outside lighting, fencing and covered parking spaces.

The IRS has determined that the contents and the land improvements will wear out more quickly than the building itself. So you get a higher depreciation deduction for these items than you do for the building itself.

Of course, even the IRS understands that land doesn't wear out, so you don't get a depreciation deduction at all for the cost of the land.

So how does cost segregation work?

It's pretty simple, actually. You merely have to determine what portion of your purchase price you paid for the land, the building, the contents, and the land improvements. While you may get a depreciation deduction of 2.5-3.6 percent for the building, you will get a depreciation deduction of 15-20 percent or more for the contents and 5-10 percent for the land improvements. Some commercial buildings will end up with 50-60 percent of the cost of the project being allocated to contents and land improvements, creating much more depreciation in the early years of ownership.

When I talk about cost segregations to a group of real estate investors, I invariably get comments that many of their CPAs don't like cost segregations. They say they are risky. They also talk about the downside to a "recapture." What these CPAs are really saying is that they are lazy.

Cost segregations take work.

But let's discuss these objections one at a time.

First, let's address the idea that cost segregations are risky, aggressive, or even that they are not allowed. The IRS has an audit guide that specifically addresses how to handle cost segregations and what the IRS requires in a cost segregation. Obviously, they are allowed. In fact, by definition in the tax law, they are required. The IRS just doesn't enforce this requirement.

Let me explain.

When you do a cost segregation on a building that you acquired several years ago (yes, you can even do one years after you purchased the building—which is good news if you're one of the folks who got bad advice from your accountant about doing a cost segregation), the change in depreciation is called a change in accounting method.

There are two types of changes of accounting methods.

The first is a change from one acceptable method of accounting to another (like changing from the cash method to the accrual method of accounting). The second is a change from an incorrect method to a correct method of accounting. Cost segregations are this second type.

This, by definition, means that not doing a cost segregation is an incorrect accounting method.
Still, you must do it the way the IRS instructs you to in its audit guide. It requires that you either use a CPA or an engineer to do the cost segregation for you. So just estimating the cost of the contents and land improvements won't fly.

At my CPA firm, ProVision, when we do cost segregations for our clients, we use both a CPA and an engineer.
The other primary objection to a cost segregation is recapture. Depreciation recapture can occur when you sell the building. Portions of the depreciation you took could be added back into your income when you sell the property.

How is this bad?

You received a deduction for the depreciation early and then paid back some of the taxes you saved later on. It's not so different from a pension, profit-sharing plan, or 401(k), except that, unlike these plans, you will never have to pay back all of the depreciation because contents and land improvements really do wear out. So when you sell the building, those things will be worth less than what you paid for them, and a smaller portion of the sales price will be allocated to these items.

You can also avoid depreciation recapture in total with good tax planning combined with a good wealth strategy.

You can avoid recapture by doing a proper 1031 exchange (also called a "like kind" or "Starker exchange") which I won't get into here but it's something you should definitely talk to your accountant about if you're serious about getting into real estate as a professional.

So don't be afraid of doing cost segregations. In fact, you should embrace them. Do them on all of your properties and you will pay far less in the way of taxes. And if you are a serious real estate investor, cost segregations could, and should, result in you never paying taxes on your rental income.

Combined with a 1031 exchange strategy, this means that a good investor should never pay taxes on his or her rental income or on gains from rental real estate.

This is the best tax advantage in the entire tax law!

So don't let it pass you by just because you have a lazy or fearful accountant!

Certain tax loopholes exist which scare less experienced CPAs. So no matter which route you pursue moving forward from here, please, please, please be sure to work with a professional willing to exploit all of the loopholes that the law allows.

CHAPTER 8:

Flipping, Flopping & Finding Money

Seeing the difference in pay scales was an important lesson I got from sitting at my rich dad's side. Seeing the difference in pay scale between a worker without a high school degree and a worker with a college degree was incentive enough for me to stay in school. After that, any time I thought about quitting school, the memories of the differences in basic pay came back to remind me why a good education was important.

What fascinated me the most, though, was the occasional person who had a master's degree or doctorate degree who still applied for jobs that paid so little. I did not know much, but I knew that rich dad made much more money per month, when you included all his different sources of income, than these very educated individuals. I also knew that rich dad had not graduated from high school. While there were pay differences between workers with a good education and those who had dropped out of high school, I also realized that my rich dad knew something these college graduates did not know.

After going through this process of sitting on the other side of the table about five times, I finally asked rich dad why he had me sit there. His reply was, "I thought you would never ask. Why do you think I ask you to just sit and watch me interview people?"

"I don't know," I replied. "I thought you just wanted me to keep you company."

Rich dad laughed. "I would never waste your time like that. I promised I would teach you to be rich, and I am giving you what you asked for. So what have you learned so far?"

Sitting at the table next to my rich dad's side in the room now empty and without people applying for jobs, I sat and pondered his question. "I don't know," I replied. "I never thought of this as a lesson."

Rich dad chuckled and said, "You're learning a very important lesson, if you want to be rich. Again, most people never get the opportunity to learn the lesson I want you to learn, because most people only see the world from the other side of the table." Rich dad pointed to the empty seat in front of us. "Very few people see it from this side of the table. You're seeing the real world—the world people see once they leave school. But you have an opportunity to see it from this side of the table before you leave school."

"So if I want to be rich, I need to sit on this side of the table?" I asked.

Rich dad shook his head. Slowly and deliberately he began, "More than just sit on this side of the table, you have to study and learn what it takes to sit on this side of the table. Most of the time, those subjects are not taught in school. School teaches you to sit on that side of the table."

"It does?" I replied, a little bewildered. "How does it do that?"

"Well, why does your dad say to go to school?" rich dad asked.

"So I can go look for a job," I replied quietly. "And that is what these people are looking for, isn't it?"

Rich dad nodded and said, "And that is why they sit on that side of the table. I'm not saying one side is better than the other. All I want to point out to you is that there is a difference. Most people fail to see the difference. That is my lesson for you. All I want to offer you is a choice of which side of the table you eventually sit on. If you want to be rich at a young age, this side of the table gives you a better chance of attaining that goal. If you are serious about being rich and not having to work hard all your life, I will teach you how to do that. If you want to sit on the other side of the table, then follow your dad's advice."

That was an important life-directing lesson. Rich dad did not tell me which side to sit on. He offered me a choice. I made my own decisions. I chose what I wanted to study rather than fight against what I was being required to study. And that is how my rich dad taught me over the years.

Action First, Mistakes Second

When I was growing up, many people asked me if I was going to follow in my father's footsteps to be a teacher. As a kid, I remember saying, "No way. I'm going into business."

Years later, I found out that I actually love teaching. In 1985, I began teaching business and investing for entrepreneurs and I loved it. I enjoyed teaching because I taught in the method in which I learn best. I learn best via games, cooperative competition, group discussions, and lessons. Instead of punishing mistakes, I encouraged mistakes. Instead of asking students to take the test on their own, participants were required to take tests as a team. Instead of silence, the room roared with discussion and rock-and-roll music in the background.

In other words,

1. Actions first
2. Mistakes second
3. Lessons third
4. Laughter fourth

My method of teaching is exactly opposite the method used in the school system. I taught in much the same way that my two dads taught me at home. I found out that many other people preferred learning in this manner, and I earned a lot of money as a teacher, often charging thousands of dollars per student to attend. I applied my two dads' teaching styles with my rich dad's lessons on money and investing. I found myself in a profession that I swore I would never enter. I may have been in the educational profession, but I catered to people who learned the way I did. As they say in business, "Find a niche and fill it." I found a very big niche, a niche of people who wanted education to be fun and exciting.

That's the way rich dad taught his lessons, and his style of teaching involved action first, mistakes second, and lessons third.

Newly Added

I am known for real estate investing. Most people read *Rich Dad Poor Dad* and think it's a book about real estate. I always get a chuckle out of that because I also use stock investing, oil investing and building businesses as examples in the book. But, for whatever reason, the real estate examples seem to be the most memorable.

I think of myself as an entrepreneur. Even when I invest in real estate I do it as an entrepreneur. I form LLCs to hold my properties and I think of the tax advantage or disadvantage for everything I do. I also focus on the cash flow of my property. Cash flow is the life blood of any business and a business in real estate investing is no different.

I am also known for cash flowing real estate. Most people who know me and read my books think I hate flipping houses. While I do not flip many houses now I used to flip houses somewhat regularly. Flipping houses has a time and a place. In my career, as a real estate investment business owner, that time was earlier on when I had little money to invest.

What Is Flipping

Flipping is simply buying a property for a low price and turning around and selling it for a higher price. It's the act of arbitrage. Most people use this strategy in the stock market. They buy a stock 'low' and sell it high. Buy low and sell high. Flippers do the same thing with real estate. I have too.

As I write this book, flipping is seen all over the television. There are shows called "Flip This House" or "Flip or Flop" and so many more. In these shows they add an extra step to flipping. These shows buy a run-down property for a low price, then rehab the property by updating its look and functionality, and finally sale the greatly improved property for a lot of money! I have done this strategy too.

Pros And Cons Of Flipping

There are some great things about flipping. The biggest is that your money is not tied up in one investment for too long. You get in. You get out. Take your profits and go do it again. Your money is moving and working hard for you.

As you know, knowledge and education are more valuable to me than money. Knowledge can be used repeatedly to make money. If you ever make a mistake and lose everything, you can use your new knowledge and old knowledge to rebuild. Flipping is so fast that you gain a lot of knowledge quickly because you learn something new with every deal. I've been doing real estate investing for over fifty years and I'm still learning.

There are some dangers to flipping too. What happens when you buy a house cheap with the intention of selling high and the real estate market crashes? Suddenly you have a house you don't want and can't sell. Your money is locked up in that house until the market strengthens or you sell the house at a loss. This has happened to me.

I thought I could time the market just right to buy low and sell high when instead I bought high and could not sell. If you have enough money it's not a big problem. You just rent the property and make a monthly profit while you wait for the market to pick back up.

But if you bought with high interest rates and can't rent the property for enough to cover your mortgage, then you are stuck with a bad investment. You can sell for a loss, get out and learn a lesson or two or you can foreclose and lick your wounds while you watch a professional real estate investor come in and buy your property for pennies.

Another problem comes when you try to rehab the property. Very often an investor will under predict the construction costs and find him or herself out of money with a house completely torn apart. Yup. I've done that too.

Generally a good experienced coach or mentor can help you avoid those problems but the next problem with flipping a house can't be fixed by a teacher.

Taxes. When the average person flips a house they have to pay capital gains taxes when they sale. No coach can beat the IRS. You flip you pay… sort of.

There are two strategies that can get you out of problems with the IRS. The first strategy is to buy the property using debt. Even your down payment should be debt. Debt is the key to avoiding taxes. When you make money from debt it is tax free. You may have noticed that in the example of my first three houses that I flipped I used credit card debt to pay the down-payment. I did that because that was the only method I had to pay the down-payment with, but I got lucky and learned it helped lower my tax burden massively. I'll discuss this further a little later.

The second strategy is to use a 1031 Exchange. A I031 Exchange allows you to exchange one investment property for another by deferring the taxes from the sale. The transaction is authorized by 1031 of the IRS Code.

The IRS Code actually reads: *"No gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment, if such property is exchanged solely for property of like kind, which is to be held either for productive use in a trade or business or for investment."*

Basically, when you sell your property you immediately put all the money into another, bigger property. You don't pay taxes until you sell the bigger property. The great thing is you can keep doing a 1031 Exchange and, in theory, never pay taxes.

The last troubling thing about flipping is that it is hard work. You have to be finding new deals constantly. If you are lazy like me, this gets old real fast. I want to invest so I don't have to have a job. But if you are not careful, flipping can turn into a full time, high-stress job. And you know what rich dad used to say J.O.B. stands for? Just Over Broke.

When Is A Good Time To Flip

There are pros and cons to flipping. When deciding if it's right for you need to take into account many factors. For me, the biggest factor was time. When I say time I mean three things, where I am in my investment goals, the cycle of the markets, where I am in my overall investment strategy.

I started out flipping houses. My first three investment properties were houses I bought at a phenomenal price, which I cash flowed for a year and then sold at a much higher price. Why did I do this? The timing in my investment goals dictated that I flip the houses. I had bought all three houses with my credit cards. I had no more room on my card so I needed to flip the houses to get some investment money for a bigger deals. I could have kept the three houses and made $35 a month from each, but that never would have helped me achieve my goal of being financially free. So I sold the houses for a big profit and then I had some real money to do bigger deals with.

At the same time it made sense to flip the houses because the market, in the neighborhood I bought the houses in, had continued to appreciate in value. The cycle in the market was near the top and the houses were not going to get much, if any, more valuable. The cycle made it advantageous to sell.

Lastly, my strategy told me to sell. I had found bigger better deals and it made sense to sell the three homes, 1031 exchange them and buy a more profitable investment that I could start my cash flow rental strategy with.

Rich Dad Taught Flipping By Adding Flipping Rules To Monopoly

I found the three homes I flipped thanks to the real estate seminar I took for $385. I felt confident and was able to overcome my fear of investing due to rich dad and his ability to teach through Monopoly.

As I've mentioned, rich dad would play Monopoly with Mike and I every Saturday. It was fun, but it was also intense. Rich dad did not just PLAY Monopoly, he TAUGHT life and investing through Monopoly.

One Saturday we were playing when rich dad picked up the dice and said, "boys, we are changing the rules." Mike and I just looked at each other. I squinted my eyes and looked at rich dad.

"You mean you are going to cheat so you have a chance at beating me." I had both Boardwalk AND Park Avenue, the most expensive rentals on the board, and was certain I was going to win. Rich dad ignored me and said, "we are going to allow flipping."

"Flipping?" Mike and I asked in unison.

"What is flipping?"

Rich dad ignored us again. "If you have a property you don't want you can sell it to another player based on the market value."

We looked confused. "Market value will be determined by cycles. The first time around the board the property price stays the same. The second time it increases by 25%. The third time by 50%. Fourth time 75%. But the fifth time it goes down from the original price by 25%. Then it starts over."

"Do we have to sell if we don't want to?"

"Nope. But I think you'll want to on the fourth time around. Especially since you'll know that the next time around you'll want to buy everything since it will be at such a large discount."

We played for hours. It took a little getting used to but we got into the idea of sell high and buying low. It was a fun new way to play. Eventually the game was over and rich dad had all the properties.

"Do you know why I won?" he asked?

"You've played this way before and know all the tricks" I replied. Mike looked down. I basically called his dad a cheater.
"No. I did not actually win."

"Huh?" this time Mike perked up.

"I did not win. You two lost. You forgot the point of the game is to get the most properties, not the most cash. I see it in real life all the time. People start flipping, see the money and forget their original investment strategy of buying rentals. While you two were busy timing the market and trying to buy low and sell high, I was focused on buying rental properties. You two kept flipping houses and I stopped after the fifth round."

"So, are you saying flipping is a good strategy at the beginning, but the way to become rich is through owning rentals?"

"That is exactly right. You get rich by collecting assets, not by buying and selling them. The rich don't work for money, they work to get more assets. Assets make you win in life. Cash does not."

The next Saturday Mike and I begged rich dad to play the Flip version of Monopoly. We stuck to his strategy like glue. Mike ended up winning and you could barely see a smile but the gleam of pride in rich dad's eye was unmissable. We had learned the lesson.

In the earlier chapters I told the story of my first three houses. About a year after I bought them on my credit card, I sold the three properties for approximately $48,000 each and put nearly $90,000 in my pocket. I was a flipper, but I was on my way to becoming a cash flow investor and a real-life winner of the game Monopoly.

Lessons On Flipping From My Seminar

My very first three-day real estate seminar was fantastic as I've already written about.

My instructor was a *real,* real estate investor. He was rich, he was financially free, and he was happy. Everything I wanted to be.

The course was practical, no B.S. The instructor used real-life examples, not textbook theory. He spoke of his wins and his losses. And, like rich dad and me, he emphasized the importance of mistakes—that mistakes were priceless taps on the shoulder, telling you, "Wake up, you don't know everything... here's something you need to learn."

At the end of the three days, I discovered that being a real estate investor was not about making money. Being a real estate investor was about being an entrepreneur in residential real estate, providing safe, affordable housing for people. If you did a good job, you made a lot of money.

If you did a good job, *the banks would lend you more money.* And, if you did a good job, *the government gave you tax breaks.* You were a partner with the government, doing what the government wanted to be done.

People who flip houses are *property traders*, a different class of *property investor.* People who flip property tend to make housing more expensive, so flippers pay a higher tax rate.

House Flipping Creates Ordinary Income

Flipping requires the personal efforts of the investor.

So flipping is taxed as ordinary income and flippers pay the same tax rates as anybody else in the S quadrant.

Most stock-market investors are like real estate flippers. They don't really want the asset; they just want the price of the asset to go up. As soon as there is enough of a capital gain, they sell—often selling in a matter of days or even hours. That is how they make money. That is why taxes on *capital gains, especially gains from flipping stocks,* are higher than taxes for passive investors, especially real estate investors who invest for *cash flow.*

Stock and property flippers pay a higher tax rate than *real* real estate investors.

Flippers or traders do well as long as the market conditions are right, but you must always account for these higher taxes when deciding if this is the right strategy for you.

Phantom Cash Flow

The instructor at the three-day seminar went far beyond how to find and buy property for nothing down. Like rich dad, he spoke about phantom cash flow, the invisible income. He taught, "Phantom cash flow is the *real* income of the rich. Phantom income is the income the poor and middle class cannot see."

In other words, he was saying *phantom cash flow* is **not** *ordinary, portfolio*, or *passive income*—income you can see. Phantom cash flow is invisible to people without financial education.

Phantom cash flow is invisible income, a derivative of debt and taxes.

The Power Of Debt- Money Is Everywhere

Now, you may be asking: *"Do debt and taxes produce phantom cash flow?*

Yes. That's why real financial education is centered around debt and taxes. Always remember this: Real financial education is about debt, taxes, and phantom cash flow... the invisible income of the rich.

Here's how this all works:

When people put money down, (like a deposit, on a house), they generally use after-tax dollars. For example, let's say a $100,000 property requires a 20% down payment. That means the property buyer must come up with $20,000. If the investor is in the 40% income tax bracket, that $20,000 really cost the investor approximately $35,000 in *ordinary income*, or *paycheck* money. Because approximately $15,000 went to the government in taxes.

So, those who are financially educated might ask: "What if the investor borrowed the $20,000, rather than used his or her own, after-tax paycheck money?"

The answer is the investor saves $15,000.

This is an example of phantom income. Are you beginning to see how this works? Because the $15,000 is money the investor didn't have to work for, didn't pay taxes on, and didn't have to save.

So by using debt, the investor is ahead of the game by $15,000. It's really like giving a runner a head start in the race. Because, while mom and pop are saving *after tax* dollars for a down payment, *the professional investor who knows how to use debt as money* is way down the road. The professional investor got a head start with phantom income/cash flow and moved on to the next investment before mom and pop even leave the house.

<u>Bottom-line</u>: *the professional investor uses debt and the amateur uses after-tax savings.*

Think about how much time and money you'd save if you didn't have to work, pay taxes, and live frugally just to save the $20,000 down payment.

"Robert, are you saying to *just borrow the $20,000?"*

Yes.

This is exactly what I'm suggesting.

This is what I did, what I do, and what I advise others to do when they're looking for their first deal. Think about this: $20,000 is *not* a lot of money for many people. Yet what happens when you need $200,000, or $2 million—or $20 million—for a down payment?

The power of borrowing is more and more evident as you borrow higher amounts. This principle is why the rich get richer. It's because they know how to borrow the money for larger down payments on properties.

But…

If you're a working person in the E quadrant trying work and save your way to riches, it's difficult to play the game you see the investors playing over in the I quadrant. Because the I quadrant is about debt, taxes, and phantom income. And without real financial education, the people in the E quadrant can't even see, yet alone understand what's *really* happening in the I quadrant.

Debt Is The Key In The I Quadrant.

Remember that debt is tax-free. Think of it as renting money instead of owning it. It's like owning a home versus renting one. When you own it, you have to pay property taxes, pay for repairs. It cost a lot to own a home. But, when you rent one? You don't pay property taxes. The owner does. When you rent one? You don't pay for the $8,000 HVAC system that needs to be installed - the homeowner does. That's the benefit of renting vs. owning and that's why smart real estate investors "rent money."

Because you save a lot of time and money, *renting money* rather than *working* for it.

And this takes a lot of skill to implement.

That's why rich dad suggested I take a real estate course before becoming a real estate investor. He said he would teach me himself but really, he'd already taken me as far as he could. It was time for me to seek better teachers. Because that's what he did too! He was constantly flying to seminars in different cities, seeking new teachers. He was always moving forward, always learning, and always seeking to level-up his network.

Rich dad often reminded me of the three wise men following a star in the heavens. Although they were already rich and wise, they never stopped seeking new and wiser teachers.

Even after you're finished reading this book, I suggest the same for you. Don't stop with what I teach you, keep moving forward. Keep growing, keep learning, and keep investing in your financial education.

CHAPTER 9:

My First Wholesale Deal

Real estate wholesaling is a great way to make money, especially when you're first starting out. This is because it requires very little money (if any) of your own. With just a few wholesale deals on your plate, you can make a lot of money quickly if you understand how to leverage OPE (other people's <u>everything</u>).

Unlike traditional real estate flipping or purchasing real estate for cash flow, wholesaling is a very short-term strategy. It can be lucrative because it can be done with limited funds and little experience. When an investor intends to wholesale a home, that means they will put the property under contract with the intent to assign that contract to another buyer.

In other words, they don't intend to live in it, rent it out, or even fix it up and flip it - they only intend to have it under contract long enough to find another buyer for the property - one who will pay a higher price than they themselves paid for it. It's like flipping but without actually buying the property.

Oftentimes, would-be investors ignore wholesaling because they think it's too hard or too risky - they worry they'll put in effort for nothing in return, or that the deal will go south and they'll be left holding the bag.

The key, however, is not to avoid these kinds of risks. It's to know how to do your due diligence so you can manage them.

The summer that I was 9, Mike and I worked hard for rich dad. We respected him, and in return, he introduced us to lessons we'd never expect to get otherwise.

One sunny day, when truth be told, I wished I was out playing baseball instead of stacking cans in a store, rich dad called Mike and me into his office. He was about to meet with a few of his advisors, and he wanted us to be able to hear what they'd have to say.

Mike and I sat quietly in a corner of the room, not sure what to expect.

Rich dad sat at the head of the table and when his advisors came in, he rose to greet them.

The gentlemen shook hands and exchanged pleasantries for a few minutes. I looked at Mike and raised my eyebrows - was this what we were supposed to be learning about? I sneaked a glance out the window and thought about how my classmates were probably down at the ballfield having the time of their lives while we were here listening to grown ups go on about… not much.

Then rich dad spoke, "Let's get down to the real reason you're here, gentlemen. Tell me - what is our plan for expanding the gardens project next quarter?"

One man cleared his throat, then replied, "Actually, we don't think that project is wise. It's too risky, and on first look, the best thing to do is to put more into - "

Rich dad cut him off, "Please show me the financials then. I have studied these numbers myself - there is a reason I asked you to investigate this for me."

The man's face grew red, and he quietly said, "I did not bring those reports. Truthfully, we did not prepare an entire set of financials because the risk looked to be too great. I am aware of what you asked, but did not want to throw good time after bad, so I created another, more conservative plan instead."

Rich dad sat silently for a moment, the tension in the room growing with every passing second.

Finally, he spoke. "This meeting is concluded. I am not interested in your advice on anything further until you can bring me all the information I've asked for, and I refuse to make another decision without it."

The advisors looked at one another uneasily, and then got up and left the room without further comment.

Mike and I sat without moving, not wanting to cause any added antagonism.

Rich dad took a deep breath and turned to us. "Do you know why I asked you to come in for this meeting?"

We shook our heads in unison.

"I asked you both in here because I was afraid that was what my advisors would say. While they're all very nice men, the truth is they're not comfortable with the same level of risk as I am. They think they're acting conservatively, but really, they're uneducated."

Confused, I asked, "Do you mean they didn't go to school?"

Rich dad shook his head and said, "On the contrary, they have had more than enough school. They just don't want to do the work to become fully educated when it comes to investments, and as such, sometimes they throw out good investments because they seem 'too risky' at first."

He continued, "You see, most financial planners think of it this way - 'the higher the return, the higher the risk'. They worry that an investment with great potential also must mean too much risk. But that's not necessarily true. The truth is the higher your financial intelligence, the lower the risk."

Mike asked, "So is this about doing the right research, and always doing your homework?"

Rich dad nodded. "Not every investment you choose will be a good investment, as no investor has a 100% track record of picking winners. Yet, the more knowledge you have, the better odds you have. When you do your homework on an investment the right way, you can maximize your opportunities for reward while still minimizing your risk."

Doing The Right Thing At The Wrong Time Causes Pain

The key to minimizing your risk is understanding which investment strategy is right for you, and which investment strategy is right for you NOW.

Wholesaling, flipping, and foreclosures are all good strategies. They are just good at different times in the real estate cycle

When the timing is right, I'll sell some of the apartment complexes I've described. Not because I want to get out of real estate, or because they're no longer producing cash flow.

On the contrary, I'll sell those properties when the timing is such that flipping makes more sense. When I combine flipping with 1031 Exchange benefits, I'll win even bigger.

Different investment strategies are right at different times in an individual's life.

While I mostly describe investing for cash flow throughout this book, there is also a wrong and a right time to flip properties and a wrong and a right time to wholesale. For example, wholesaling is a good way to raise fast money to get the investing started. So, it's often good for people with less money who are just starting.

The key to winning lies in two things - one, understanding the market so you know when and how to act, and two, having the guts to jump in when it's time to do so.

So, Wholesaling - What Is It?

You may have heard of because it can be done with no money and very little experience.

But that doesn't mean it's easy.

Wholesaling is a word that real estate professionals and house flippers use when they're talking about the process of connecting the dots between sellers and buyers and getting paid for it. And when you do it legally, you can make a lot of money quickly.

My First Wholesale Deal

Because my rich dad taught me to buy low and sell high, (especially during a recession), I was ready to do my first wholesale deal.

This was when houses that used to sell for $100,000 were selling for $75,000.

And this is exactly the right time to strike.

Instead of shopping with local real estate agents, I began shopping at the bankruptcy attorney's office, and the courthouse steps (more on how you can do this later on in the chapter). In these shopping places, a $75,000 house could sometimes be bought for $20,000 - or even less.

Yes, really!

I found one of these $20,000 deals and ran with it. Here's how: after I found the single-family home they were literally giving away for $20,000, I gave an attorney a $2,000 cashier's check as a down payment. Because I knew to leverage OPM, it wasn't even my money! The $2,000 was loaned to me from a friend for 90 days and I promised to pay him back the $2,000 plus an additional $200 for the cost of the loan.

The deal got started.

Here's where the dots get connected during a wholesale deal - while the acquisition was being processed, I ran an ad offering a $75,000 house (which is what it was worth) for only $60,000 and no money down. The phone rang hard and heavy. Prospective buyers were screened and once the property was legally mine, all the prospective buyers were allowed to look at the house.

It was a feeding frenzy.

As you could guess, the house sold in a few minutes.

I asked for a $2,500 "processing fee" (some call this a finder's fee), which they gladly handed over, and the escrow and title company took over from there. I returned the $2,000 to my friend with an additional $200.
He was happy, the home buyer was happy, the attorney was happy, and I was happy. I had sold a house for $60,000 that cost me $20,000.

The $40,000 was created from money in my asset column in the form of a promissory note from the buyer. And my fee as the "Wholesaler" was an easy $2,500 which anyone will pay if they're getting a great deal and saving money on the purchase anyway.

As a wholesaler, I located a motivated seller (in this case, the court), found hungry buyers, and charged a fee for connecting them. This, in essence, is a how a wholesale deal works.

On my very first one I made $42,500.

Total working time: five hours.

In hindsight I should have taken one more step that would have made me a lot more money.
I should have saved the contact info of everyone who called me wanting to buy my house. I had created a list of real estate buyers without even intending to.

With that list in hand, I could have gone back to the bankruptcy attorney's office and bought two more houses. I would not have had to post another ad in the newspaper, I could have simply called the people that were on my list.

Who knows how many times I could have done that, but I know I missed an opportunity to make even more money with even less work.

Real Life Example: A Wholesaling Story

Here's another story to show you how wholesale deals can be put together.

Rick is a wholesaler.

He spends his week finding awesome real estate deals, but doesn't want to actually get into them. One day, Rick got a call from Rachael. Rachael wanted to sell her house but didn't want to go through the hassle of using an agent. She told Rick that her house needed some work, and just wanted to get rid of it or put money into fixing it herself.

She just wanted out.

This is what you call a "motivated seller."

Rick went to see the house and after determining what would be needed in way of repairs, he offered Rachael $75,000 for her house. Rachael said "you have a deal," and they signed a purchase agreement. The agreement stated that Rick or anyone else he "assigns the contract to" would buy the home for $75,000 within the next 14 days.

Then, Rick gave his buddy Nathan a call (well, he probably called him before he signed the purchase agreement). Nathan was a very active house flipper who Rick knew well. He already talked to Nathan about the house, what it needed as far as rehab goes, and how much it'd be worth after it's fixed up (also known as the After Repair Value, or A.R.V.).

So, Rick offered to sell the property to Nathan for $80,000.

Now, Nathan knew he could turn a healthy profit at that price after he fixed it up because he had a good idea of what the A.R.V. would be.

They agreed on the price and moved forward. Rick and Nathan signed an *"assignment contract"* which legally means that Rick was letting Nathan buy the house from Rachael.

That's it.

Rick could do this because he already signed a purchase agreement with Rachael saying that either Rick **or someone else** would buy the home in 14 days.

Next, Rick drove downtown and gave all the paperwork to the title company. When it was all said and done, Nathan paid Rachael $75,000 for her house, and Rick kept the additional $5,000 difference as his finder's fee (similar to the $2,500 I was paid for the deal I mentioned above).

Do you see how powerful this is?

Rick never owned the house for a second but he made $5,000 on it. Because he connected Rachael (the seller) with Nathan (the buyer/house flipper). And this is just one way (probably the most common one) that wholesalers structure deals and make money.

So...now that you have a general understanding of what wholesaling is and how it works, I want to address some questions you might be asking right now.

Is Wholesaling Illegal?

A topic that gets debated more than anything in real estate investing is the legality of wholesaling. Some say it's ok, some say it's not, and some people are in between. Truth is, there isn't a black and white answer here because the laws and regulations differ in every state.

Before I give you my take on it, I would encourage you to take $250 and use it to pay a real estate attorney in your area to let you know what you can and can't do legally.

The wholesaling debate all revolves around what real estate people call "brokering." Now every state has its own definition of the term but what it essentially means in any state is this: *someone who puts a real estate deal together.*

Pretty simple eh? And, of course, intentionally vague.

Simply put, a broker is one who engages in brokering. Those who would say that wholesaling is illegal say so because they say that the wholesaler is acting as a "broker" in the deal without having a real estate license.

But those who say that wholesaling without a real estate license is legal and okay, say so because, they say, wholesaling isn't considered "brokering" because all the wholesaler is doing is just signing a contract and assigning it to someone else, without acting as an agent.

They say that the law does apply to wholesalers in this regard because they're not selling a house, ***they're just selling a contract.***

And the lines get really blurry here because *both sides of this argument have valid points.*

To muddy the waters even more (as if they weren't already unclear enough), those who think wholesaling is illegal say you can't legally market a house that you don't even own. In our example deal from earlier, Rick the wholesaler bought a house from Rachael then sold it to Nathan. But, some would argue, if Rick put an ad online to try and find buyers, he'd be "marketing the property" and that would be illegal because he has no legal authority to do that as it's not his house.

So some questions pop up and there isn't a clear cut answer to any of them:

- What exactly defines "marketing a property?" It's vague at best
- If Rick knew Nathan personally (which in this case, he did) and told him about the deal beforehand (which in our example deal, he did), would that be considered "marketing?"

Now to be clear, a lot of wholesalers operate legally, and a lot of them operate illegally. I live in Arizona and there are a lot of wholesalers here. But the laws vary in every state on this so you must do your homework before you jump in.

If you sign a purchase agreement with a seller, then post an ad online to try and find a buyer, you have to be careful. Because ***depending on where you live and how you go about doing the deal,*** you could be doing something illegal.

Ask yourself this: do you feel comfortable explaining your reasoning and intentions in front of a real estate commission? How about a judge?

You have to know the law here, I can't stress that enough.

A Better Way to Wholesale

Here's what I advise everyone to do who wants to get into wholesaling so they protect themselves no matter where they live:

1. **Talk to a Real Estate Attorney**
2. **Get Your Real Estate License:** Kind of a no-brainer isn't it? If you have a real estate license, you can legally wholesale all day long without penalty. No one can accuse you of brokering without a license if you have one.
3. **Actually Buy and Sell the Property**: Instead of assigning a contract to someone, buy the house the old fashioned way and then re-sell it. Just a few more hoops to jump through which you can actually do all in one sitting anyways (i.e. you can own the house for 10 minutes and sign it over to someone).

You're an adult so you can decide what to do and how to go forward in your area.

Like I said, it's a gray area in almost every situation so whatever you do and however you do it, use good judgment. But the easiest way again is to get your real estate license **<u>or</u>** buy the house (or lot, or multi-unit building, whatever it is), get the title, and then sell it afterward.

Where To Find Cash Buyers

Cash buyers are going to be local investors and/or house flippers. You don't need a list or huge roster of them either, you just need one, maybe two guys or gals and you can do this all year long, month after month.

You have to network.

Get out and meet people, join the local REI club, look around online, and ask Realtors for a list of recent cash deals that have closed in your area (or find them yourself on the MLS).

The fact is buyers are easy to find.

You just have to put in some time. You might already be friends with someone who knows a cash buyer or house flipper - you just have to access your network to find out. Start asking around. Use Facebook, email, other social media channels, personal conversations - all of it. Let people know what you're looking to do, and I assure you, you'll get connected with cash buyers who are very interested in the deals that you're going to bring them.

Wholesaling Is Hard Work

If you're looking for the easy way to make money, *wholesaling isn't it.*

As a real estate wholesaler, you have to be well-versed in many aspects of real estate and you have to be diligent. There are other investors who can outbid you and offer better deals than you. In the example scenario I gave you earlier, Nathan ended up paying $80,000 for the property. But what if he just found Rachael first, and if Rick and Nathan ended up competing, Nathan could just outbid him. So...who do you think Rachael is going to go in that scenario? Obviously, she's going with Nathan (the flipper) and Rick (the wholesaler) gets nothing.

Because Rick can't compete.

As a wholesaler, you need to work incredibly hard to find these deals. You have to hustle. This isn't for lazy or unmotivated people. It's for people with a vision and drive.

This is a business.

Every successful business takes hard work.

But know this: good wholesalers make good money because they do multiple deals a month. You can do it, too, and at $5,000 a deal (the average price for wholesale fees), you only need a few deals to see a decent payday.

You must know what your buyers and investors are looking for:

- You have to interview buyers AND seller
- You have to take notes to know what the buyer/flipper wants (specifically
- You have to ask questions, do your homework, and make it happen
- You have to be AMAZING with people
- You have to be a network
- You have to know how to sell
- You have to know how to connect the dots
- You have to pound the pavement, chase leads, and make the deals happen

If you have time and motivation (the two things everyone needs to make it as a real estate wholesaler), get ready to do very well.

Build a Business (Not a Deal)

Your goal as a wholesaler isn't to do just one deal, but to do several of them.

To make that happen, you always want to have a full pipeline. That means that when one deal closes, another falls in line and takes its place. To get to this point takes time. For you to have a consistently full pipeline you have to find the leads, make the calls, send the letters, build rapport with sellers and investors, doing due diligence, know your numbers, prepare documents, and make sure everything goes well at closing. Real estate wholesalers who hustle can have over 20 deals going at one time.

Do the math on that. $5000 x 20 = **$100,000 in profit.**

Not bad for just connecting some dots. And this is just the beginning…

The natural question is how are you gonna get these deals in the pipeline in the first place? There are several ways to find deals. I will give you a few of the more common ones below. These will give you a great place to start.

Remember- creativity is essential. The more outside the box you think, the more likely you'll be able to find sellers on your own.

1. The MLS

The MLS is where every investor, Realtor, and wholesaler likes to hang out so please listen to me when I say - don't bother! If you approach a house flipper with a deal you saw on the MLS, chances are they've already seen it. Although you *can* find distressed properties on it and connect with sellers, it's very competitive and won't be your best way to connect with motivated sellers. But keep it in your back pocket and use it when you have to.

2. Take a Drive

Take a drive in your area and look for distressed properties that are for sale. You know a run down house when you see one. If it looks like it might be something someone wants taken off their hands, find out who owns it and see if they want to make a deal.

3. Snail Mail

This is how a lot of people get started as full-time wholesalers.

When you send out highly targeted letters to motivated sellers, you'll be shocked at how many of them call you back. You can purchase leads online, find them by looking up public records, (probate, divorce, trustee auctions, etc.), or use an online program to find them.

Bottom line, there are a thousand ways to get the names of people who might be in a position to sell quickly (e.g. someone who is delinquent on their property taxes). When you find these people, send them a letter and let them know you're interested in buying.

A sample general letter could say something like this (and of course you'll want to modify it per the situation). You can also try sending postcards as they're usually cheaper. Whatever you do, make sure you include a phone number (don't use your cell phone, use a free Google Voice number instead. This way you can track calls easier, and your personal number won't be out there).

Here's a sample template:

Mr. Jones,

My name is Robert Kiyosaki. I'm a local real estate cash buyer and I understand that 456 Main St. might be for sale. I'm not a real estate agent and I was thinking that we could both save ourselves some money on paying out real estate commissions.

I can close quickly (in days, not months) and purchase the house as is, where is, with no inspection.

If you're interested in talking, can you give me a call at (123) 456-7890?

Talk soon,

Robert

Now you might send out 1,000 letters and spend five hundred dollars doing it, but if it results in even one sale (or a few) it'll be well worth it.

4. Get Creative

You can also use Craigslist, put signs up (you've seen those before on the side of the road right? They're called "bandit signs"), or try my favorite method - co-wholesaling.

Co-wholesaling is when you find a seller and have no buyer(s) lined up. So what do you do? You get in touch with the house flippers and investors *you know* and just ask them, "Hey do you know anybody who's looking to buy? I found a sweet deal over at 123 Main St…"

Now, chances are they know someone who's looking for deals or they want to buy it themselves and if they're the ones connecting you with the buyer, they get a piece of your wholesale fee too. Instead of making $5000, you split it at $2500 a piece, and hand off the deal to the other guy.

Easy money right? Now do that several times a month, along with the other methods I've mentioned and your phone WILL ring.

A Good Deal?

If you don't know how to work with numbers, you must learn.

Otherwise, this won't work and you shouldn't pursue being a wholesaler. Once you get in a rhythm, the numbers and formulas are easy and you won't even think twice about them. Since you're only making money when other people make money, you have to reverse engineer this entire thing. The house flipper has to make money on the deal or they won't buy it from you. To put a good deal together, you have to know what *they* want and what *their* margins are.

It all starts with the ARV, or After Repair Value (which I mentioned earlier). Once you have that number in mind, you need to work backward:

1. How much the house flipper wants to make on each deal
2. Rehab costs
3. Misc costs (fees, holding costs, etc)
4. Your profit (how much you want to make)

Now, once you have that number, you'll know the most you can pay on the deal. It looks like this:

Your offering price = The A.R.V. – the total of the (4) cost areas above

Here are the numbers from a recent deal a friend made with a wholesaler to show you how the numbers work:

John (the wholesaler) found a single-family property here in Arizona. Because he knew how to check comps, he found out that the A.R.V. of the house was about $590,000. He also knew a local investor (Jennifer) and knew that she usually likes to make around $30,000 profit on all of her flips.

Because he did his research and walked through the house, he determined that the miscellaneous costs (i.e. closing costs, commissions, etc.) would be about $77,000. After walking through the house with a contractor, John determined that it needed about $60,000 in rehab.

Lastly, John wanted to make $5,000 for his wholesale fee.

So John's offer price to the seller was determined like this:

His offering price = $590,000 – $30,000 – $77,000 – 60,000 – $5,000
The price he gives the seller = **$418,000 (or less)**

With an offer like that, everyone wins.

- The motivated seller gets paid and sells their house.
- The house flipper makes $30,000 on the deal after it's rehabbed and sold.
- And John makes $5k for simply connecting both parties.

As you are probably thinking right now, this takes skill.

Common Formula Questions

How did John know that the miscellaneous (or "fixed") costs would be $77,000? And how did he know that it would need $60k in rehab? In order to calculate like this, you need to spend some time learning your numbers, getting help from a coach, writing down your formulas, building relationships with contractors, and making sure you understand all of this before you talk to even *one* potential seller.

There's a lot of money to be made, but also a lot to be lost if you approach this the wrong way.

Talking To The Seller & Making Your Offer

What happens next? It's time to make the offer and put your *selling hat* on.

You need to sell yourself and simultaneously *devalue the property* to make the owner realize that what you're offering them is in fact a great deal. You're also going to offer to buy the property "as is, where is, with no inspection."

This means that no matter what's wrong with it or how much work it needs, they don't have to pay (or wait for) an inspection, and there won't be any rehab or repair costs on their part.

They need to realize that you're assuming *all the risk* on this deal and you're paying cash quickly (like, next week). This needs to be framed as ***an offer they can't refuse.*** Because nobody wants to pay repair costs or fix their house before they sell it. They just want it off their plate with money in the bank.

Help them out and *let them know* you're helping them out. As in you're doing them a favor. Now, traditional purchase agreements have an "inspection contingency" built in. This means that a potential buyer (you in this case) can back out of the deal if you don't like what they see or hear post-inspection.

This is a huge hassle for the seller too (if a buyer backs out). If that happens, now they have to find someone else to jump through all the hoops in the purchasing process.

But…

...what if other sellers back out, too?
...what if the seller won't be able to sell their house unless they take care of some repairs first?
...what if they can't afford to make these repairs?

Did you know that the entire home inspection process can tie up their house for 2 weeks, and most traditional deals take 30-45 days to close?

That's means that the seller won't see any money for about 60 days, plus they might have to pay for repairs on the house just to get someone to buy it. Additionally, the buyer can still back out anytime. These are the types of things you need to press when you're making your pitch to the seller.

And that pitch should sound something like this:

You approach the seller and say something like this:

"I know you're asking $499K for your house, but I'm countering at $418K and here's why: I can pay you cash on Thursday and I'll buy your house as is, where is, with no inspection. This way you don't have to worry about repairing anything that needs fixed, you don't have to jump through all the inspection hoops, and you'll literally have cash in hand next week."

Of course, every deal and situation is different, but you get the idea. You **HAVE TO** sell yourself. Be confident, be prepared, know your numbers, and go make that deal.

Post-Deal Action

If you make the deal and then turn around and assign the contract to someone else, most sellers won't care. The reason is simple: all they want is to get paid and have the property off their plate. Just to be safe, you should always let the seller know what you're going to be doing so there won't be any surprises at closing. At closing, you, the seller, and the buyer all show up, everyone signs, and the deal is done.

Now it's time to get paid.

Getting Paid

All you need to do to get paid after the deal is give the title company your information and purchase agreement and then wait. Some states use attorneys instead of title companies, so whichever it is, they just need to see the contract and they'll give you your money.

Now that you did your first deal and it was a win for everyone, you go out and do it again, and again, and again.

Push your profit from the first deal back into your business and use it to get more leads, more deals, and keep your pipeline full (remember - those mailers cost money). One deal won't set you up for long-term success, but doing several a month will put a good chunk of cash in your pocket.

Knowledge is the new money and a financial education is worth more than any college degree you could go into debt to pay for. My poor dad never understood this. He said, "When it comes to money, play it safe. Don't take risks."

My rich dad told me I had to learn to manage risk.

This is the difference between the poor and the rich. One takes risks, one avoids them. Wholesaling is a risk. Make no mistake about it. If you go into it fully prepared to manage the risk, you can do very well for yourself.

With a simple to follow structure like this, you have no excuse to not get started right away.

Wholesaling With Monopoly

As you know, I think a great way to practice anything is with games. Rich dad did not teach Mike and I about wholesaling but, I often imagine how he would have used Monopoly to teach the concept. Here is how I would do it.

Imagine you are playing Monopoly but you can "buy" a property for 50% of its listed cost. You can buy everything you land on! But there are a few rules.

- You pay the bank your 50% of the listed price (the price on the Monopoly board) when you sell the property, not when you contract from the bank. You do have to give the bank something though so,
- When you wholesale from the bank you give them 5% down at the moment you purchase the contract from the bank.
- Nothing you buy can charge rent. This is because you don't actually own the property, you own a contract on the property.
- After you pass go you must give the properties back to the board. This means...
- You must sell the property to another player BEFORE you pass go. This is because wholesale contracts are for a very short time.
- The price you sell the property for is at a 10 - 20% discount. This make other players want your properties.
- When the players buy from you, you must give the bank their asking price, which was 50% of the listed price.

Playing this way you will never win the game, but you will learn the basic concepts of wholesaling real estate and that could turn into a win in real life.

CHAPTER 10:

Due Diligence

When it came to real estate, rich dad had two questions.

1. Does the property generate a positive cash flow?
2. If yes, have you done your due diligence?

The most important financial ratio of a piece of real estate to rich dad was his cash-on-cash return which is calculated with the following equation:

Cash-on-cash return = Positive net cash flow divided by Down payment

Let's say you buy an apartment building for $500,000. You put $100,000 down and secure a mortgage for the $400,000 balance. You have a monthly cash flow of $2,000 after all expenses and the mortgage payment are paid. Your cash-on-cash return is 24 percent or $24,000 ($2,000 fix 12 months) divided by $100,000.

To me, cash-on-cash return is the easiest and surest way to know if a real estate investment is worth your time and money. There are also more complex equations you can take into account:

- **Internal Rate of Return:** This is a return on an investment that assumes all the income (passive/cash flow) you receive is immediately reinvested so that you would be getting a return on that money as well.

- **Net Present Value:** This takes into account an estimated discounted rate for the future value of money. It takes the value of the money invested today and compares it to the value of the future cash flow at a discounted rate of return.

Each equation has its strengths and weaknesses, and none of them are as straightforward as cash-on-cash return. They rely on estimates, which can create widely varying valuations depending on the quality of the analysis.

As the old saying goes, "Garbage in; garbage out."

Additionally, before buying the apartment building, you must decide how you will purchase it. Will you buy it through a C corporation, an LLC, or a limited partnership? Consult with your legal and tax advisors to make sure that you choose the entity that will provide the most legal protection and tax advantages to you.

Once rich dad determined whether a real estate investment provided enough cash-on-cash return, he would then make sure he was getting what he paid for through due diligence.

How I Find Good Investments

In my opinion, the words "due diligence" are some of the most important words in the world of financial literacy.

It is through the process of due diligence (the careful evaluation of a potential investment to confirm all material facts) that a sophisticated investor sees the other side of the coin. When people ask me how I find good investments, I simply reply, "I find them through the process of due diligence." Rich dad said, "The faster you are able to do your due diligence on any investment, regardless of whether it is a business, real estate, a stock, or bond, the better able you will be to find the safest investments with the greatest possibility for cash flow or capital gains."

Once you have determined that a piece of real estate will generate a positive cash flow, you still need to perform due diligence on the property.

Rich dad had a checklist that he always used. I use a due-diligence checklist as well. It is very thorough and includes items that did not exist years ago (such as "Phase I Environmental Audit").

And, if I have questions about the property, I often bring in the experts and have my attorneys and accountants review the deal.

My Due Diligence Checklist

The File Audit

Purpose: To verify the actual potential income calculation.

Look for:

- A signed rental agreement on every unit to ensure you have binding contracts.
- Monthly rental rates from the rent roll that match the numbers used in your offer.
- Security deposits that match the amounts reported to the escrow agent. They belong to the residents, so they transfer to the new owners.
- The quality of the residents in each unit. Do they pay on time? Are they creating problems for other residents? Have credit background and criminal checks been completed on all residents?

The Interior Inspection

Purpose: To help you learn about the physical property, get a sense of the quality of the residents, and help you understand the exposure to your future cash flow should you purchase the property. You'll determine the actual condition of the personal property and get a feel for the extent of major repairs.

Look for:

- Clues about the lifestyles of the current residents. I've witnessed everything from major drug activity to people living in squalor. Think about what you are seeing. A resident living without furniture, sleeping on the floor, and keeping his articles in a Hefty bag could be a future vacancy.

- Residents not living in units that the seller had designated as rented. Some sellers inflate their rent rolls and list residents who don't really exist, or simply have such bad records that they do not know the current rental picture.
- Missing furniture, appliances, or items near the end of their useful life. Make a list of all appliances, carpet, vinyl floors, and cabinets that fall into these categories.
- Major water, fire, or resident damage to the premises and contents.
- Telltale signs of pest problems in each unit and document any pest control needs.

Government Agency Reviews

Purpose: To determine that the property is in compliance with government standards.

Look for:

- Fire code violations. I invite the local fire department to complete an inspection. This inspection with our Portland project discovered an old fire sprinkler system in need of repair that even the current owners didn't know about.
- Outstanding permit problems. Have any remodels, additions, pools, and so forth been added without proper permitting?
- Environmental concerns such as asbestos, mold, lead paint, or radon.
- Existing ownership issues like zoning violations or encroachment onto another property.

Service Agreement Review

Purpose: To determine the service commitments of the current owner and look for ways to improve them should they survive a transfer of ownership.

Look for:

- Pool service agreements.
- Heating, air conditioning, and cooling service agreements.
- Landscaping contracts.
- Coin-op laundry equipment service contracts.
- Cable and alarm contracts.
- Parking contracts.
- Advertising contracts.

Exterior Inspections

Purpose: To evaluate all exterior components of the property and determine when they may need repair or replacement.

Look for:

- Roof problems, including signs of leaks and overall disrepair or wear.
- The condition of heating, ventilation, and cooling systems and the equipment service and maintenance records. What is the repair history and the age of each piece of equipment?

- Electrical wiring that is not in compliance with current codes.
- Plumbing that is aged, corroded, or leaking and the type of plumbing. Copper, PVC, and galvanized plumbing all have their own unique problems.
- The condition of the exterior paint and trim.
- The condition of the driveways and parking lots. Are they cracking and full of potholes? What repairs are necessary?
- Landscaping problems, including irrigation and sprinkler system breaks, large trees that need trimming, and root growth that is cracking sidewalks or causing foundation problems.

The purpose of this entire inspection process is to put an estimated cost to each item in the list - not simply for cost sake but to arrive at a total number that we can take back to the seller and discuss. What if the property is not in compliance with the fire department? What if there are environmental hazards? What if three out of the eight units obviously need new carpeting? In many cases, if you bring these issues to the seller's attention, they can be fixed before you close.

That saves you money—in some cases, lots of it.

Books And Records

As important as it is to know everything about the physical property, you absolutely need to dig just as deep into its operations. That means looking at the books and records. This is also the time to begin gathering information for your operating budget by categorizing the income andexpenses.

These Are The Things I Review In Great Detail:

- <u>Twenty-four months of income and expense statements</u>: I compare the income and expenses to the projections. This is the time to make notes for the operating budget and flesh out all the unusual expenses or major periods of rent loss. Discuss these with your seller or broker before the due diligence period ends. You absolutely want to meet your deadlines.

- <u>All service agreements</u>: I look for those agreements with termination clauses longer than thirty days. I verify that these costs are in the operating budget, whether the service is needed, and also what service are missing. I assess the current management company and determine whether they stay or go.

  I review all advertising agreements for effectiveness. It's worth your time to look at all these agreements because you could find yourself locked into them. Any contract you don't want to assume, you need to spell it out before the completion of due diligence.

- <u>Current rent roll</u>: This is when I verify the actual income, the actual potential income, and the future potential income to the penny. Take a hard look at every unit that is under the market rent. This is your golden egg "Advance to Boardwalk" card that will create an increase in your cash flow after you purchase the property. Take detailed notes for your management plan and operating budget.

- Utility bills: Here I verify all the utilities. Call the utility companies and get the last twelve months' operating history on each account. Ask about increases for the next year. Finally, insert the revised figures into your budget.

- Payroll information: On larger properties I look at who is working at the property and how much they are paid, especially if I want them to stay and work for me or the management company. When assuming these employees, treat them like new hires. Be sure to find out the accrued vacation information. We also run a criminal and credit background checks on all new hires as well as complete a drug screening before we acquire them.

In addition to securing everything on this list, I also physically walk and inspect the property, including each unit if purchasing an apartment building. I take inventory of all damages and use that inventory list to negotiate a fair price.

I've seen lots of investors who skip their due diligence get burned big time.

Don't do it.

In the end, the recipe for real estate success is easy:

Success = Cash flow + Due diligence

Do those right, and you'll be in great shape.

In Webster's dictionary, the definition of "diligent" is "prosecuted with careful attention and effort." But it's really the synonyms for the word that reveal exactly what is expected during the due diligence period when purchasing investment real estate.

The synonyms for "diligent" include "conscientious, thorough, careful, thoughtful, attentive, and meticulous." Thanks, Webster, I couldn't have said it better myself.

And that's exactly how you need to behave when you do due diligence on a property. You need to conscientiously review every document pertaining to property operations:

- You need to perform thorough walk-through of every apartment unit.
- You need to pay careful attention to every detail.
- You need to be thoughtful about how you can improve the property and cut expenses.
- You need to be attentive to the tasks and deliver them on time.
- You need to be meticulous in your evaluation and reporting.

And that's really what the due diligence process is. It is your time to take a thorough look at everything pertaining to the property and report the good, the bad, and the ugly. It's the time when you make detailed assessments of actual costs for property improvements, ongoing maintenance, and operations.

It's your last chance to make sure you have uncovered every hidden flaw, are aware of every possible problem, and are realistically projecting the opportunities. The goal of due diligence is to find out 100 percent of everything there is to know about the property and generate an operating plan and budget from that information.

In my years of buying property, I've uncovered everything imaginable during due diligence.

In one building, while doing a thorough unit-by-unit walk-through, I found everything from vacant units that were supposed to be occupied (falsified rent rolls), units that cannot be leased because fixtures have been removed to repair other leased apartments (cannibalized units), a loose ten-foot-long boa constrictor left behind by a resident, a naked man in what should have been a vacant unit, roof damage so bad I could see daylight, innumerable missing appliances, units missing carpeting, you name it.

You'll be surprised by what you find.

Or in some cases, you won't be surprised at all.

But either way, you'll rest much easier after the whole process is over and you know the property you are purchasing has been fully revealed to you. You'll be loving the language in your purchase and sale agreement that says all units must be rent-ready at close of escrow!

Right now you're probably thinking there are a thousand things to look at related to a property. This would take a year to accomplish. You're right, there are a lot of things to look at and evaluate, but you're wrong about the timetable.

The bad news is you don't have a year to accomplish the due diligence.

Rather, you typically have about thirty days.

"What?!That's impossible!" you might think.

I thought that too, but then I remembered, I have a team, and they can make the due diligence process much easier, way more manageable, and actually a good time.

To me, due diligence is really kind of fun. I guess it's the element of surprise and of finding the unexpected—both for the good and the bad. It's like an Easter egg hunt, and come to think of it, as a kid, I used to like those too. You just never know what you are going to find. But unlike my preparation for an Easter egg hunt, I come to the due diligence process with much more than an empty basket.

In all cases, because I was thorough on the initial property valuation, I have a strong belief that whatever I find is fixable. I also take comfort in knowing that anything I find that would cost me money to fix is a final negotiation point before the sale closes.

That's right: If you find that the property requires any type of major repair, such as a new roof, exterior painting, new appliances, termite extermination, snake and naked man removal, you can get estimates and factor the costs into the final valuation and purchase price. That's what I call finding the golden egg!

For me the due diligence process is an exciting time. Sure I get some great stories out of what I see, but more importantly, I know that whatever I find will be documented for the next round of discussions with the seller.

The due diligence document is my report card to evaluate how well I estimated the numbers during the Five Step Property Evaluation. In many cases, the problems I find during due diligence either result in a reduction in the price of the property or, better yet, they are fixed before we close escrow.

It's this kind of information that is only going to help you be more successful with whatever property you purchase—this one or another.

We recently found a new landscape company in this way. I received a monthly landscape contract on a property we were considering. The landscaping looked great and I was surprised to see the cost was much lower than what I was paying at some of my other properties.

In fact, it was lower than what I budgeted for this project!

This one find is saving me thousands because now this landscaping company does the bulk of our work at this and our other properties.

Regardless of whether I find hidden jewels like a great landscape company I didn't know about before, or buried warts that if missed would have negatively impacted cash flow, I am happy. Happy because additional revenue opportunities are always great and happy because any problems now in the open give me additional bargaining leverage.

Only the stuff that isn't found during due diligence is scary to me.

Once the sale is closed, you're stuck with any and all hidden problems. And they can cost a lot. Imagine not checking the property's drainage only to find that after a big rainstorm raw sewage drained into one or more of your apartments.

Don't laugh, it happened to a friend of mine on Maui.

And the costs to clean up all the damage and correct the drainage problem were huge. (It was a crappy deal.) That's why, as you can imagine, I am very diligent during due diligence.

You should be, too.

CHAPTER 11:

The Grass is Always Greener

Every town has its swampland.

When you're first starting out in real estate, you need to watch your neighbors.

Really, I mean it. Next time you drive to work, take your son or daughter to school, or race down a highway you've traveled hundreds of times, look to the right and the left. (Maybe I should say glance repeatedly - it's safer that way.)

But what I mean is this: take the time to really look around.

I travel roads - the same ones every day - just like you do. I think I know the area.

You probably think you do, too. After all, you pass by the same houses, the same stores, the same apartment buildings, the same office parks every day, right? Well, caution here. This type of complacent "knowledge," the knowledge you get by passing by, can be dangerous when it comes to property investing. First impressions and outward appearances of cities or towns and the neighborhoods within them—also called markets and submarkets—can be deceiving.

So can buying anything in a market you know nothing about.

You've heard the saying, and it's true, a lot of swampland gets sold to unsuspecting buyers not just in Florida but in every city and town across America. *Every town has its swampland.* You know - it's the investment that sucks up all your resources and offers nothing in return. And let's face it, getting people to venture into the murky water is a lot more challenging with alligators lurking around.

If we learn anything from all those poor people who have purchased swampland with the hopes of striking it rich, we should take away one lesson:

The market is more important than the property.

I'm always amazed by how much there is to know about a specific market or even a small submarket just a few blocks in size. What you see on the surface is just the beginning. And just when I think I know an area really well, something changes. In this chapter, I'll show you how to get beyond the appearances, avoid the swamps, and see the true picture of a market and its smaller submarkets. And in the process you'll gain objectivity—a very good thing indeed when it comes to real estate investing.

The Problem With Gut Feelings

Too many people purchase investment real estate on a hunch or a gut feeling. And while it is important to have instincts, understand that they are the products of experience, not a right of birth. This gets back to the myths.

People are not born knowing this stuff. I believe it is impossible for a person who has never done a single investment deal to have an instinctive knowledge that one deal will be better than another. It's not that simple. In fact that's the kind of naive thinking that gets investors off to the wrong start.

Rich dad once told me that, "Sometimes well-intentioned people will lead you in the wrong direction, but they'll provide opportunities to learn. Other times, you'll make good decisions and your journey will go a little smoother."

"What's the biggest investment mistake you ever made?" I asked him.

He laughed and said, "I've been asked this before, and out of all the mistakes I've made, the biggest one was trusting myself too early. Because when you're starting a new venture with little or zero experience, there's a lot of fear and anxiety involved. So oftentimes, you default to your gut feeling. Which is fine if you have the knowledge and experience to back it up. But when you know nothing, your gut feeling can get you in trouble."

"Ok, but what about how you're always telling me to trust my gut?" I shot back.

"It's easy for me to say this now," he said.

"But, I only recommend trusting your gut if you've been through the good and bad, success and failure, and have the real-world experience under your belt to know whether or not to trust your gut. Basically, you have to train your gut feeling to be accurate and that only comes with experience."

"Well, how do you know when your gut is right?" I asked.

"I was once in the same place you are now. I was brand new to real estate and after reading, and researching, I got to my first deal. I took action. And then I did another, and another, and another. You can only read and research so much, and then you need to take action. This is where you gut is developed and trained - *in the action.* Because when you have to start making decisions that affect your life, your financial well-being, and your overall goals you're giving yourself and your gut a practical financial education."

"And when the next deal comes along, you'll know what makes sense and what doesn't because you've been there before?" I responded.

"Exactly that!" rich dad replied.

"So, you kind of answered my question about your biggest failure. But, how did trusting your gut too soon get you in trouble?" I asked again.

"Well, after I had a few deals under my belt, I thought I was a hotshot. Even though I was on my way to being rich, I wasn't 'there' yet. One day a gentleman called me with a deal that seemed too good to be true. After talking on the phone, I went to his office, met his team, and decided to move forward on an investment deal."

"I'm waiting for the bad part." I quickly blurted out.

"Yes, that's coming Robert." he said.

"Now, even though everything looked good on paper, that wasn't why I did the deal with him. I did the deal with him because my gut told me to trust the guy. He was a religious man. He was very generous and even picked up the bill at our meals. My gut feeling told me that this was an honest straightforward man. And boy was my gut feeling wrong." he said.

"What happened?" I asked.

"The short version is this - the guy was a total fraud. He'd been running a Ponzi scheme and the small amount of money I put in on the deal didn't go toward a property - it went to pay off other investors." he said woefully.

"So the 'always trust your gut' advice is wrong?" I asked.

"Well, no. It's good advice with one qualifier - you have a gut that's had enough experience to be reliable." he said. "Because my gut told em to go through with the deal even though the guy I did the deal with turned out to be a crook who stole millions from several investors. And I could have avoided the whole thing if I had slowed down assess whether what my gut was telling me was right."

"So, a gut feeling about your gut feeling?" I said half-jokingly.

"Sort of. Back then I had no reason to trust my gut. Now though? I go with my gut all the time. Because I've seen the good, the bad, and the ugly in the real estate world and know almost instantly whether a deal is worth it or whether I should run from it. This is because of real experience. Nothing else will train your gut faster." he replied.

"That makes sense." I said.

"I'm glad you're starting to understand. That was a difficult lesson for me because I lost money with the guy. But I used my mistake as an opportunity to learn." he said.

"Okay, but how will I know when I *can* trust my gut?" I asked anxiously.

"Again, it's based on experience. The ability to trust your gut doesn't happen in one shot. It develops over time as you get more experience. That's why I'm a fan of *doing,* not talking. That's how you learn and grow in anything, not just real estate."

"What should I do now though? If my gut isn't reliable yet, how do I know whether I'm about to get rich or get screwed?" I asked.

"Easy. There are a few things you can do now to make sure you're protecting yourself. The first one is always have a Plan B. Always. Never go 100% in without an exit strategy or contingency in place. Remember Monopoly?" he asked.

"Of course." I said.

"You need to have a 'get out of jail free" card in your back pocket on every deal. Because if the deal goes bad, you need a way to get out. For every deal I do I put together two or three back-up plans in case something comes up or the deal goes south. I go in with my eyes wide open. I make a scenario around every single thing that could kill the deal or go bad and I try to plan ahead for each of them." he told me.

"What else?" I asked.

"The second one is simple because you're doing it right now." he said smiling.

"Getting a mentor?" I replied.

"That's it." he said with a grin. "You need to find and learn from people who know more than you do in every part of the deal. That way when you're come up against something you're not sure about, you can lean on them for help and insight. What do they think about the deal? What are there thoughts on the different pieces of it? This is really the only way to succeed - with a team." he said.

"Glad I'm already on the right path." I said.

"You are Robert. And you'll still fail. Everyone screws up sometimes. But to get rich, you have to get back up and keep going. The thing that helps you get back up is knowledge. Because when you know that you're learning valuable lessons from your failures, you'll train your gut and increase your confidence and expertise with every decision." he replied.

Save Gut Feelings for Twenty Years Down the Road

How do you start without a gut that's reliable (yet)?

It's not magic and there's no shortcut. Until you have a battle-hardened gut in place, you need to do one thing really well: *learn how to evaluate your market and submarket.* You must get to know your target area and become an expert in it. Not for the sake of merely being an expert, but for the ultimate purpose of finding a great property investment that is viable and profitable for the long term. That's what we're shooting for here. If you can accomplish that, the rest becomes easy.

And that goes for finding and keeping residents, which directly impacts your cash flow and profitability. I've been in business for a long time and even I don't rely on instincts alone. Before we ever invest, we do our homework.

To be honest, we have no choice.

Knowing everything about the potential market is the only way for me to make realistic projections about future profitability.

In every deal I've ever done, it was the only way I could feel comfortable about making an investment. Knowing the market inside and out was the key to knowing if the project would be viable. Fact finding is the opposite of relying on gut feelings. In the last chapter I discussed due diligence, yet there are still a few important concepts that are worth defining further here.

Supply And Demand

When it comes to investing in property of any kind, particularly rental property, I make sure my first objective is to get an accurate read on the supply and demand in the area. I'm not talking anything complicated, just basic economics. Supply is defined as the number of rental properties available in a market or submarket.

Ideally, supply should be low and demand should be high.

Demand is defined as the number of people looking to rent. Supply is easy to determine. A good place to find this number is by asking brokers and property managers. They usually have detailed data, including property names, sizes, addresses, and dates of construction.
Seek out this help; why do all this work on your own?

Demand, on the other hand, is a bit trickier.

I estimate demand based on occupancy rates in the area. If a submarket has high occupancy, demand is great. If occupancy is low, demand is soft.

Another indicator of demand is the prevalence of move-in incentives and specials. If there are a lot of move in specials advertised, demand is low. If rental properties are offering no incentives at all, demand is high. These are some outward signs. Another factor to consider when determining supply and demand is future supply.

By future supply, I mean any and all new rental property that is in various stages of development, from planning to permitting to construction. Future supply is a critical indicator of how properties in the area will perform long term.

If through your research you find that supply is greater than demand, you may want to stay away or at least keep looking for a better market. Your job of finding residents, generating cash flow, and increasing the profitability of the property will be more difficult. And remember, the value of a rental property increases based on its operations and cash flow.

My colleague Ken McElroy chose a waterfront project in the River District submarket because the demand certainly exceeded the existing supply. He knew this based on his face-to-face meetings and the fact that nothing was available in the area to rent.

But by contrast, in the small mountain community of Fountain Hills, Arizona, the opposite is true.

In Fountain Hills, rental properties, including large apartment communities, and uncountable numbers of duplexes, condos, and single-family homes seem to be everywhere. Many were purchased by hopeful investors. And now they are competing head-on for a relatively small number of renters. The reasons for this lopsided market state are no mystery. Rather,they are totally explainable.

Have you figured them out yet?

You Didn't Learn This In Economics Class

There are three drivers of a market's or submarket's economics that come into play. As an investor in real estate, you'll want to keep each of these variables in the forefront at all times. They are true indicators of supply and demand.

EMPLOYMENT

This is the first and possibly most important indicator of demand and for good reason. If a market or submarket has lots of jobs, people will come to fill those jobs. Very basic stuff. It is a fact that jobs drive residency, so with all things being equal, property that is near to employment is in greater demand.

That's not to say that people won't drive to live in a highly desirable city or town or that people won't drive to their job. But just be aware of the market condition. When you're looking for indicators of supply and demand, look at employment. In the case of Fountain Hills, Arizona, there is little to no employment base at all. Nearly everyone who lives in the town, who is of working age, works elsewhere, like in neighboring Scottsdale.

Scottsdale, by contrast, has many employers.

Both Fountain Hills and Scottsdale are desirable places to live and both communities are beautiful places with excellent qualities of life. But Scottsdale wins in terms of employment, and therefore, in terms of demand.

People have to really want to live in Fountain Hills, and many do.

But the lack of a large employer or large office complex that brings workers to the town means that Fountain Hills will find it difficult to balance the supply and demand for rental properties for many years to come. This same theory is also true for the town's retail businesses and restaurants.

Employment opportunities bring customers.

It is a fact that population follows employment.

The saying that people go where the jobs are is true. It's what attracted people to Houston, Texas, in the late 1970s and early 1980s, and it's what has been attracting people to Phoenix, Arizona, for the last twenty years or so.

Create jobs and people will come.

High employment can be beneficial for rental property investments, but be sure to look at the whole picture. Even communities with lots of jobs can still be overbuilt, thus throwing off the delicate balance of supply and demand. Scottsdale has been smart to limit the supply of rental properties. That has helped keep the vacancies low and the rents high.

Fountain Hills, with its plentiful land by contrast, allowed the construction of too many rental units and therefore vacancies are higher and rents are lower. Fountain Hills could have been a premium rental community even without a strong employment base and once was before a boom in rental properties occurred in the mid to late 1990s. After all, the town is a tremendous draw for winter visitors and part-time residents, usually a good market for rental communities.

Employment stability is also something to consider. As you evaluate your market and submarket for employment, look at how stable the employment base is. Are the companies reputable? Are their products or services in ever growing demand? Is the mix of companies diversified?

These are indicators of stability.

Just look at Houston in the 1980s. Rental properties were booming and then the oil industry came crashing down, taking with it banks, hotels, home-building companies, and numerous other businesses. Apartments were vacant all over town, so to lure renters, owners and property managers were offering ridiculous move-in packages, including six months' free rent, free televisions, and no security deposits.

A significant drop in the local employment had a significant impact on the economy.

POPULATION

In a world of choices, choose to have your investment rental properties where the people are!

We've already established that you need a stable and growing employment base, so it makes sense that you'd also want to be in an area where there are lots of people - people who are your future customers. That may be a bit cut and dried for the new investor who's thinking about taking advantage of a "great deal" on a single-family home on the outskirts of town, off the beaten path.

While it may be a wonderful property, and seem like a great deal, that's meaningless if nobody is around to lease it. Once the market is selected, the key to success is in the property itself and valuation is a function of its operations—how well it operates now and how well it will operate in the future. By operations, I mean how much income the property generates, what the expenses are, and what the overall profitability is. Operations success in this business relies on a market of renters.

People certainly go where the jobs are.

But they also migrate to places that have a certain persona or living experience built into the area. That's a somewhat vague concept, I know, so it may be best to use examples rather than try to explain it. If you've ever been to Venice Beach in California, you know that it's a submarket of the Los Angeles market that has a definite persona or living experience. First of all, it's a California beach town that conjures up all the fun and freedom that the California Office of Tourism, Hollywood, and the Beach Boys spent decades promoting through commercials, movies, and songs. Next, it's a submarket even among other beach town markets because it has a reputation for being edgy, avant-garde, and youthful.

Purchase investment property in Venice Beach and you wouldn't have to say much more. Lots of people are drawn to this lifestyle and the persona of what living in Venice Beach means.

Contrast that with the Phoenix submarket of Dobson Ranch. There are rental properties in this master planned community, but the area has no real persona to drive the multitudes to it.

Sure, it's a nice place to live and a great place for families, but there's no major image that draws population. I'm sure most everyone reading this book has never even heard of it.

Other areas that come to mind when I think of living experience and persona are Key West, Florida, and Coronado Island, California. They both are exclusive beach resort communities.

Whistler, British Columbia, is another example. The name is almost synonymous with skiing and stunning alpine scenery. Gig Harbor, Washington, is a mecca for boating enthusiasts. Aspen, Colorado, is the place to ski and be seen. And finally Scottsdale, Arizona, is known for sun, golf, spas, and shopping. These are famous places that possess personas, but there are other less famous areas in every community that have unique personas and living experiences that are known to those who live in the region.

Take some lesser known areas in Arizona: Litchfield Park, which was once known as the location of Luke Air Force Base and a lot of farms, is now readily known in the Phoenix metro area as a boom-town with lots of development, a sports arena complex in neighboring Glendale, and retail everywhere you turn. Mill Avenue, a submarket of Tempe, Arizona, is well known as a youthful, happening, artistic college center. Do you understand through these examples the concept of persona and living experience?

Places that have clearly defined personas are population draws almost as powerful as employment. The lure of charming buildings in towns that lack employment and a solid persona have tempted even the best of us, me included.

But don't be caught!

Charming buildings in towns with lots of people stay charming after the sale. And they get even more charming when they are making money.

Unless you're a Vegas gambler who always tries to beat the odds, stay away from markets and submarkets that are not drawing people.

Now that you know some of the reasons why markets attract people, you'll need to know how to quantify the population in your area. Here's another time when the team comes into play. Talk to your city or town officials, visit their Web sites and set up meetings. Remember, as a taxpayer, you are paying their salaries. You are their customer. Do whatever it takes to get realistic population projections, and when they rattle off blue-sky numbers, ask them to elaborate on the factors they see contributing to this optimistic growth scenario.

If any of your sources project population to decline, that's a bad sign. But at least they are honest. I always look for real indicators from people, not blue-sky, and value them for telling it like it is. In addition to employment and town persona as population draws, your contacts may also refer to the following:

- **New highways or highway extensions.** These create new traffic patterns and transform areas that once seemed a long distance away into places that suddenly seem close by. If a new highway project is slated near that single-family home off the beaten path we talked about earlier, it may not be such a bad investment opportunity after all.

- **Master planned communities.** These large residential projects combine home and work and with them draw lots of people. New communities in particular are usually backed by big-dollar advertising campaigns and the older ones like Dobson Ranch mentioned earlier in this chapter become yesterday's news.

- **New sports stadiums and arenas.** So often the hub of urban redevelopment is a sports stadium or arena complex. These facilities bring tens of thousands of people to an area and open up all kinds of opportunities for investment real estate. The Phoenix Coyotes hockey arena as well as the more recent Cardinals Stadium in Glendale have been two of the most important projects in the recent emergence of neighboring Litchfield Park, the boomtown I mentioned.

- **Universities and university expansion.** Universities are always population drivers because just by the nature of what they do, they bring a steady stream of students, faculty, and supporting businesses to an area. The Mill Avenue submarket of Tempe that we spoke of earlier is in walking distance of Arizona State University.

- **Redevelopment areas.** Ken's River District project in Portland is an excellent example of a redevelopment area. The ideal central locations, community goodwill, and an aura of "coolness" often associated with redevelopment makes these kinds of projects population magnets. People love the 'wow factor' associated with before-and-after stories.

- **Casinos.** Casinos bring with them the masses who every weekend and a lot of weeknights want to try their luck and win big bucks. They say that in the Gold Rush of 1849, the people who made money were the ones who housed the miners and sold them goods. The same is true here, except the gamblers at the slots are the modern-day miners.

- **Military bases.** Not all military personnel live on base. The property around government installations is often a good investment. Just be careful of base closings, which are often in the news around government budget time.

- **Regional airports.** Scottsdale's airport is a prime example of how valuable real estate can be around airports. The Scottsdale Airpark is a haven for small businesses and a real driver of rental communities and single-family homes in the area. A brand-new highway linking the airport to the rest of the Phoenix metro area didn't hurt, either.

- **Company relocations.** When Boeing moved from Seattle to Chicago, with it went thousands of jobs. Bad for Seattle, great for Chicago. Corporate relocations are instant population boosters.

- **Major events.** The 1962 World's Fair redeveloped downtown Seattle and the legacy of that event is the Space Needle, which is still a tourist attraction decades later. Olympic Games also have a way of transforming communities, as the 1996 games did in Atlanta and the 2000 games did in Salt Lake City. Even annual events like the Super Bowl can completely revitalize an area through huge injections of new money.

These are just a few population drivers and when you see, hear, or read about them, they are good indicators for growth. Projects and developments such as these tend to reshape the face of a community, and change of this type is potentially lucrative for real estate investors.

But there are also a few things to watch out for:

- **Resilience.** Make sure that the growth of a market or submarket isn't too heavily reliant on one thing. In other words, if one major employer is responsible for nearly all the population in a given area, think twice about investing. If the employer moves, so will your market. You want a market that can withstand the ups and downs. Motorola has significantly scaled back its Phoenix operations, which could have been devastating to many cities. Phoenix's strong, diversified economy and vigorous small-business community minimized the sting.

- **Economic Diversity.** I steer clear of areas that don't have a good diverse economy. It's happened before and it will happen again - an entire market falls victim to an industry sector that goes bust. It happened in Pittsburgh, in Houston, in Detroit, and in the San Francisco Bay Area when the dot-com bubble burst.

- **Pioneering.** Pioneers have a romantic place in history, but I make a point of never being one. Being too far out on the forefront of things can be expensive and dangerous. I try not to create the wave - I simply catch a wave I see beginning to build and ride it in.

- **Affordability.** I always look at the affordability of housing in a particular market. If a single-family home is out of reach for most people, apartment living becomes a valuable option. This is the case in big cities like New York and San Francisco, which attract large populations, most of whom cannot afford homes. Look for markets where the cost of home ownership far exceeds the cost of renting. The closer the two variables are to each other, the harder it is to find renters and the harder it is to keep them.

LOCATION

Location is the most important thing when it comes to real estate - at least that's what everyone says. And I agree. But to me, locations have to be evaluated not based on geography alone, but based on how they measure up in relation to supply and demand.

After a location has met the criterion of being in an area with good employment prospects and a growing population, I look for a few important physical features that experience has shown to be valuable:

- **Great locations have drive-by visibility.** The more cars that pass by your property and see your "For Rent" sign, the better your chances of success. Drive-bys are one of the most effective forms of advertising and certainly one of the most cost-efficient. When your property is on a street with no traffic, you'll have to resort to more expensive and less effective methods of advertising. This almost inevitably reduces your profitability because lower occupancy means lower cash flow.

- **Great locations possess a rare quality.** There's a one-of-a-kind quality about great locations that you can't find everywhere. Ken's Portland project was one of the only waterfront properties left in a wildly popular area. It was an island waiting to be found. That's the rare quality I'm talking about.

- **Great locations are in demand.** Some investors think they can't afford to even look at property in the hot locations. I hear this often. But the truth is affordability is everywhere, even in the hottest neighborhoods, if you buy the property based on operational performance and not on the sale price. Just know for now that you should never rule out A-plus neighborhoods.

Take another look at these three characteristics of great locations and what you find is that they add up to one simple truth: Great locations are low in supply and high in demand. This is at the heart of your market evaluation. Be realistic with your analysis and look at the future of the market with a keen eye on the present. Property investing should pay off now and later. The first step in buying right is knowing your market better than anyone else.

Focusing Your Market

After all the evaluation is said and done, you should be armed with the information you need to narrow your market. A few chapters ago we talked about goal setting. I put forth as an example the goal of finding an eight-unit property in Phoenix.

The goal was as follows:

We will acquire one eight-unit property in your metro area within the next twelve months that will generate at least $4,000 of average annual income over the next five years.

After reading this chapter, you should now be thinking that "your metro area" as a market is way too broad.

That should be narrowed considerably.

As you learn more about your own market, you will find yourself continually refining your goal and your search. That's perfectly fine. This gradual focusing is necessary and those who can't do it effectively find this type of work . . . well, a lot of work.

So let's now refine our market to Scottsdale.

That's much better.

And we'll focus it even further to the Old Town area, a sub-market of Scottsdale. I now know that my property choices will be in the hundreds, not the tens of thousands. Now do you see what I mean about a lot of work?

You need to start in your own neighborhood to find deals. Yes, the grass might be greener on the other side - but it still has to be mowed.

CHAPTER 12:

Tax Liens & Auctions

Coupon Clipping Is For The Poor.

To find a bargain, the poor and middle-class clip coupons, scour newspapers, and check emails from daily deal websites.

They spend hours of their time and waste gas driving across town to buy an item for a few cents cheaper than the store down the street.

The rich like bargains too, they just go about it differently. They scour the Internet and drive all over - except they are looking for deals on real estate investments instead. They understand that markets have their very own kind of "sale." They know that when the masses are keeping their distance, there are bargains to find.

They also know that real estate auctions and tax-lien certificates (TLCs) are one of the best-kept secrets to find real estate "on sale". This can help you build the cash flow you need for less than comparable properties through "traditional" methods.

How To Find Bargains While Doing As Little Work As Possible

When I want a piece of real estate, I look at many properties and generally write an offer.
If you don't know what the right offer is, neither do I. That is the job of the real estate agent. They make the offers. I do as little work as possible.

Several years ago, I had a piece of real estate that I wanted to sell for months.

I would have welcomed any offer. They could have offered me 10 pigs, and I would have been happy—not at the offer, but just because someone was interested. I would have countered, maybe for a pig farm in exchange. But that's how the game works. The game of buying and selling is fun. Keep that in mind. It's fun and only a game. So, make offers. Someone might say yes.

I always make offers with escape clauses. In real estate, I make an offer with language that details "subject-to" contingencies, such as the approval of a business partner. Never specify who the business partner is. Most people don't know that my partner is my cat. If they accept the offer, and I don't want the deal, I call home and speak to my cat. I make this ridiculous statement to illustrate how absurdly easy and simple the game is.

Not Everyone Can Make It In Real Estate - How Can You?

- **Go to the market. Don't wait for the market to come to you.**
  You must go to the market and talk to a lot of people, make a lot of offers, counteroffers, negotiate, reject,

and accept. I know single people who sit that home and wait for the phone to ring, but it's better to go to the market. Searching, offering, rejecting, negotiating, and accepting are all parts of the process of almost everything in life.

- **Jog, walk, or drive a certain area once a month for 10 minutes.**
  I have found some of my best real estate investments doing this. I will jog a certain neighborhood for a year and look for change. For there to be profit in a deal, there must be two elements: a bargain and change. There are lots of bargains, but it's change that turns a bargain into a profitable opportunity. So when I jog, I jog a neighborhood I might like to invest in. It is the repetition that causes me to notice slight differences. I notice real estate signs that are up for a long time. That means the seller might be more agreeable to deal. I watch for moving trucks going in or out. I stop and talk to the drivers. I talk to the postal carriers. It's amazing how much information they acquire about an area. I find a bad area, especially an area that the news has scared everyone away from. I drive it for sometimes a year waiting for signs of something changing for the better. I talk to retailers, especially new ones, and find out why they're moving in. It takes only a few minutes a month, and I do it while doing something else, like exercising, or going to and from the store.

- **Shop for bargains in all markets.**
  Consumers will always be poor. When the supermarket has a sale, say on toilet paper, the consumer runs in and stocks up. But when the housing or stock market has a sale, most often called a crash or correction, the same consumer often runs away from it. When the supermarket raises its prices, the consumer shops somewhere else. But when housing or the stock market raise their prices, the same consumer often rushes in and starts buying. Always remember: profits are made in the buying, not in the selling.

Look in the right places.
A neighbor bought a condominium for $100,000. I bought the identical condo next door for $50,000. He told me he's waiting for the price to go up. I told him that profit is made when you buy, not when you sell. He shopped with a real estate broker who owns no property of her own. I shopped at the foreclosure auction. I paid $500 for a class on how to do this. My neighbor thought that the $500 for a real estate investment class was too expensive. He said he could not afford the money, or the time. So he waits for the price to go up.

The lesson here? You have to get creative, think outside the box, and look for deals in places other than the MLS or Zillow. Everyone does that and that's why everyone doesn't make it in real estate. To be at the top 1%, you have to think outside the box.

A couple great places to start - tax liens and auctions.

Understanding Tax Liens

After *Rich Dad Poor Dad* was published, many people asked, "Is he saying that a person should not buy a house?"

The answer to that question is, "No, he was not saying not to buy a house." Rich dad was only emphasizing the importance of being financially literate.

He was saying, "Don't call a liability an asset, even though it is your house." The next most asked question was, "If I pay off the mortgage on my house, will that make it an asset?" Again, the answer in most cases is, "No, just because you have no debt on your home, that does not necessarily make it an asset."

The reason for that answer is again found in the term cash flow. For most personal residences, even if you have no debt, there still are expenses and property taxes. In fact, you never truly own your real estate outright. Real estate will always ultimately belong to the government.

The word "real" in "real estate" comes from the Spanish word "royal." It does not mean "physical or tangible" here. That's because property has always belonged to the royals. Today it belongs to the government. If you doubt that statement, just stop paying your property taxes and you will find out who really owns your property, with or without a mortgage. The non-payment of property taxes is where tax-lien certificates come from.

In Rich Dad Poor Dad, I wrote about the high interest that investors obtain from tax liens. Tax liens are the government's way of saying, "You may control your real estate, but the government will always own it."

Rich dad was very much in favor of home ownership.

Poor dad was, too, but for a different reason. Poor dad often told me the way to get ahead in life was to get a good job and buy a nice home - that a house was a sound investment and a great asset. Poor dad believed, "Our home is our largest investment and our greatest asset."

Rich dad believed, "My house is a liability, and if your house is your largest investment, you're in trouble."

Rich dad often reminded me that a home was not an asset, but instead a liability. One day, I went to his home for lunch. As we walked out to the patio overlooking the beach, I complimented him on his large and beautiful home. I wondered aloud when I would have a house of my own.

He thanked me for the compliment, then told me, "Robert, make no mistake. After all these years, you know as well as I do that a home is not an asset, but instead a liability."

I'm sure my face fell at that - it was disappointing to think that I shouldn't want to own a nice home.

Rich dad noticed my reaction and paused for a second. Then he continued, "Even though a home is not necessarily an asset, it's still a secure place to put your money. It's not that you shouldn't buy a home of your own - rather, you should endeavor to collect enough assets to pay for it."

Reflecting on all I'd learned so far, my attitude brightened. "So I am already on my way, then!"

He nodded. "Even though my home is technically a liability, I still get to enjoy living here. My real assets have generated the cash flow that allowed me to buy this big beautiful home. Hopefully, yours will, too."

The point he was making was that people should not call a liability an asset, or buy liabilities that they think are assets. He thought that was one of the biggest mistakes a person could make.

He would say, "If something is a liability, you'd better call it a liability and watch it closely."

How Tax Lien Investing Works

As briefly mentioned, tax liens are the result of someone not paying their taxes, usually for an extended period of time. When that happens, a tax lien is imposed on a property to secure such tax payments. These can result from someone being late on property taxes or even their own personal income taxes. It's essentially a claim against the property for the amount of outstanding taxes owed by the owner.

Why Are Tax Liens Relevant In The Investment World?

When a tax lien is issued against a property, that property cannot be refinanced or resold until it is paid for and removed. This means the property essentially becomes dormant until someone can pay the lien. But if you understand the process of how tax liens are issued, then you may recognize an investment opportunity. What happens is this: the issuing of a tax lien means a certificate for the amount owed is created. Since the certificate represents a specific dollar value, it can be auctioned off to those willing to purchase it.

How Do You Profit Ffrom Buying Property Tax Liens?

Let's assume that you've won an auction and have been awarded the rights to a tax lien certificate.

Generally, you will be required to immediately pay back its value to the entity that issued it. The issuer is usually a municipal body.

After you've made this payment, you now own the rights to the lien and must notify the property owner.

Next, you must structure a deal where the property owner will work to repay you. This includes the principal of the loan plus interest on top. Interest rates will vary across states, so you should consult local regulations before doing this.

At this point, you will be collecting loan payments from the property owner, unless for some reason they can't make them.

If the owner paid the loan successfully, then the deal is over. However, if they have not fully paid the loan by the end of the agreement, you as the investor have the option to foreclose the home. Now, it turns into a foreclosure investing deal.

To answer the question about how one profits from tax lien investing, consider this. In the first case, you will have collected the full principal amount of the loan plus a comfortable interest rate. In the latter case, you now have a foreclosed property, which presents an opportunity to earn a return on your initial investment. However, the latter scenario is thought to be rare so you should expect to earn your money through interest payments.

Some Words Of Caution

Tax lien investing is known to get very complicated and is not recommended for novice investors. There are so many variables at play here.

1. **Owner's willingness and ability to repay a loan.** There are many factors that affect this condition. You should consider things like the state of the property, the neighborhood, the income of the owner and anything else that could affect the repayment of the lien.

2. **Knowing the legal procedures.** For example, you must immediately notify the property owner once you take control of the lien. It's important that you follow any rules and regulations.

3. **Expiration dates.** All tax liens come with expiration dates so you must take this into account when structuring your deal. It would be unfortunate if the lien expired right in the middle of your deal.

The bottom line is that you should always do your research to understand all of the opportunities out there. This includes understanding the inherent risks that come with each investing option. Tax liens present a unique real estate investment opportunity, but should not be taken lightly.

Find New Investment Deals Through US Real Estate Auctions

In my day, we went out and reviewed a hundred properties just to close one deal. It took weeks, even months, but this was one of the best teaching tools I could have encountered. By looking at all those deals, I learned to narrow down exactly what I was looking for and what I was willing to pay when it came to a real estate property.

One of my employees came in a few months ago, all excited because she'd just bought a house online … through an auction!

Of course, I know a little about real estate auctions and have stood on quite a few courthouse steps to listen to trustee foreclosure deals. Mainly, however, I was in attendance to get educated about that avenue for finding investments, not to bid.

I frowned at my employee and gave her my two cents of wisdom about dangers to watch out for when buying a property on the court steps. The main danger is not being allowed to see the property, which means you can't conduct your own due diligence. A second danger, especially for someone like me, is getting caught up in the bidding process. It's hard not to get focused on winning the bid rather than getting the best deal.

My employee just gave me a smile with a hint of smirk. "Robert," she said, "that's not how this works. This is an *online* auction."

A good friend was telling me about an online auction site. The site hosts the biggest online auction for real estate in the world, with over $26 billion in sales since 2006, and is where my employee bought the investment property she was telling me about. I had to know more, so I recently sat down with her to learn about this new way to buy property.

It turns out she used the auction site to review *hundreds* of deals. What would have taken me weeks or months to accomplish in the traditional way took her days, even just hours. And every property at the auction site is for sale; it's not like looking at properties on Zillow. It's not window shopping—it's shopping at the frenzied discount of blowout sales!

I grimaced when she told me that she bought that investment property locally and sight unseen. But then she explained: She bought the investment at such a great deal that the land the property sat on was worth more *just by itself* than the bid price they paid for it. It turns out that you *can* go look at the property and do your proper due diligence, but in this case it simply wasn't necessary.

She invested in that property for $35,000 and after fixing it up, she has seen it revalued at $219,000. With margins like that, cash flow isn't going to be too tough. She bought the property when it was a dilapidated state and so had to put more money into it, but the margins remained huge and the whole investment ended up being a no-brainer. She already has renters in the property with cash flowing in every month. She's also already submitted a lot more bids on the auction site.

She had title of the property just one week after submitting her bid. I've never had a property sale go so fast. And she did the whole deal from her computer. She did research, found financing, got it bought and paid for—all from her desk.

Now, it's not all easy. Auctions, just like any investment deal, require a lot of research and may take multiple bids before the price can be made to match the value. Following her success with the first property, my employee has submitted many bids but still hasn't been awarded a second property. It remains a process, one that still requires work.

After being introduced to this new form of auction I got a little education. I learned that online auctions cover all sorts of properties from residential to commercial, from bank-owned to individual-owned. One of the beautiful parts of online auctions is the transparency, since you get to watch all the other bids and therefore know exactly what's going on at all times. It's plain to all bidders that winning an auction is not based on who you know or how well you can "sell" your bid. You simply place your bid, increase your bid (if necessary), and win; or you can try again on a different property.

Here is how to get a good deal with online auctions:

- Do your homework on the market
- Look at related comps in the area
- Speak to property management companies to learn facts about rent in the area, which includes
    - looking at rental rates in the area
    - finding out how long it takes to rent in the area

- Speak to a construction general contractor to learn about what the property needs and the cost it will take to affect those changes
- Walk the property with your contractor and property manager
- Have a max number you are willing to pay before the action—AND NEVER GO OVER IT

Of course, there are also missteps to be avoided when accessing online auctions. Many mistakes come from bidders trying to take shortcuts and/or not controlling their emotions. The most common errors made on Auction.com include:

- Getting too excited and overbidding on a property
- Not properly evaluating repair costs
- Not properly estimating rental rates
- Not inspecting the property in question

Auctions have undoubtedly been around for quite some time now.

A real estate auction is just like any other, except that it only offers properties. Generally, a property will not be listed for auction just for the sake of it. Auction properties tend to result from defaulted mortgages or outstanding tax liens. Either a homeowner has missed consecutive mortgage payments or has neglected tax payments. In the first situation, a person's property will be listed for auction if they continue to miss mortgage payments. However, homeowners can prevent this by paying the outstanding balance or renegotiating the terms of the loan agreement.

In the latter case, by not paying property or income taxes, homeowners can legally have their property seized from their possession.

What Are The Different Types Of Real Estate Auctions?

Once the property has been seized from a homeowner, it will end up in one of the following two auction types:

- **Foreclosure auctions:** Properties end up in foreclosure auctions if the mortgage was defaulted on. In this case, the lender is not allowed to profit from the proceeds of the auction. If a profit still exists after all expenses and liens have been paid, it goes to the previous owner.

- **Tax lien auctions:** Properties end up in tax lien auctions if the previous owner neglected tax payments.

In either case, the bid for property starts at some base amount. Generally, this is equal to the outstanding balance of the mortgage or possibly even lower. Auction participants proceed to bid until the highest bidder is identified.

What Happens Once The Highest Bidder Is Identified?

Depending on the structure of the auction, there are two ways this could play out. Consider the following:

- **Lender confirmation auction:** This auction structure leaves it to the lender's discretion as to whether or not the highest bidder should be approved.

- **Absolute auction:** This auction structure awards the property to the highest bidder no matter what. So long as the individual has the necessary cash on hand, they will receive the property.

Now that we know how a winner is determined, let's discuss the pros and cons of real estate auctions.

The Advantages Of Real Estate Auctions

There are two primary benefits of turning to real estate auctions to find an investment property.

- **Potential to find cheaper prices.** Often, you can find good deals on properties through this channel. There are more risks associated with auctions so this results in less interest as compared to traditional channels. Knowing this, there will likely be less competition between buyers.

- **First chance at properties.** Auctions present the opportunity to get the first view of select properties. As an investor, it's hard to complain about being the first to prospect an opportunity.

The Disadvantages Of Real Estate Auctions

Despite the benefits offered by real estate auctions, you must also consider its drawbacks.

- **Large cash requirements.** This varies between auction companies, but typically you will be required to provide a down payment in order to secure your bid. This can be as high as the minimum bid amount and is usually made in the form of a cashier's check.

- **You may encounter surprises.** Surprises can be good sometimes. Other times, not so much. With auctions, you don't always know what you're going to find within a property. This is especially a problem since you can't always inspect the property before bidding on it.

- **You won't necessarily win.** Depending on the nature of the auction, specifically if it's a lender confirmation auction, you may not always win despite being the highest bidder.

- **Additional stresses.** Other issues might come up, such as having to evict the previous owner if they still reside in the property.

Remember that it never hurts to explore new sources of investment properties and real estate auctions can present a great opportunity. Today's market is filled with many opportunities for the savvy investor.

You simply need to know where to look.

CHAPTER 13:

CASHFLOW "Aha" Moment

Rich dad's real estate investing philosophy was primarily based on cash flow. His idea of success or failure is based on the answer to one question: Do you have positive cash flow at the end of each month? If you do, your investment is almost certainly a success.

There is also the popular philosophy that real estate generally goes up in value—capital gains. While you're earning that extra income each month, you're paying down your mortgage each month at the same time.

Slowly but steadily, you are building more equity into the home. And since real estate properties may gain in value over time, your original investment of $110,000 in that home may also be appreciating in value.

In other words, if 10 years from now you decide you want to sell the home, the market value of the house might have gone up to $125,000. So on paper, you would make a nice tidy profit of $15,000 from the sale of the house as well as all the passive income you collected.

Many people look at the idea of accruing income from a sale and declare any investment that might sell for more than they bought it at a success, but a word of caution from rich dad: "Always keep your eye on your cash flow. Look at potential appreciation in real estate as a bonus, not as a reason to buy."

Focus On Cash Flow

After 1971, when Nixon took the dollar off the gold standard, inflation began to creep into the economic system. People knew something was wrong, but without much financial education, they did not know what was wrong. In 1980, gold hit $850 an ounce and silver went to $50 an ounce as inflation blasted off.

Under President Ronald Reagan, Federal Reserve Chairman Paul Volcker put his foot down and raised the federal funds interest rate to 20 percent in an effort to kill inflation.

A new word entered the common vocabulary: stagflation. The economy was stagnant (people and businesses weren't making more money), yet inflation was growing (things were getting more expensive).

I remember going into restaurants and seeing menus where prices were crossed out repeatedly. They were increased almost on a monthly basis. Business stalled, yet prices kept going up to pay for rising costs.

Even though home mortgage rates were high - 12 percent to 14 percent - home prices were starting to skyrocket. I bought a condo in Waikiki in 1973 for $30,000 and sold it for $48,000 two years later. I purchased three condos on the island of Maui for $18,000 each and fixed them up for about $48,000 each, making around $90,000 in about a year, nearly six times what I had been making as a Marine pilot.

I thought I was a financial genius.

Thank God my rich dad sat me down and talked some sense to me. The next phase of my financial education began. I was no longer a little 10-year-old boy playing Monopoly with rich dad. I was now in my mid-twenties, and I was playing Monopoly for real.

Patiently, rich dad reminded me of the differences between capital gains and cash flow. It was a good reminder. At that time, every time I bought a property, I was investing for capital gains. Rich dad informed me that the tax laws were different for capital gains and cash flow, just as they are today.

"Invest for cash flow," were rich dad's words. "Remember the lessons I taught you years ago from Monopoly. Investing for capital gains is gambling."

Just as when I was a child, he took out a deed card from Monopoly and said, "How much do you receive for one green house?"

Taking the card in my hand I said, "$10."

Even though I was now nearly 30 years old, I recalled his lesson on the differences between capital gains and cash flow; lessons I had learned as a little boy, but had forgotten as an adult.

"Good," said rich dad patiently. "And how much for two green houses?"

"$20," I replied.

"Good," said rich dad sternly. "Don't ever forget that. Invest for cash flow, and you'll never worry about money. Invest for cash flow, and you will not be wiped out in boom and bust markets. Invest for cash flow, and you'll be a rich man."

"But," I began, "it's easier to make more money with capital gains. Real estate prices are skyrocketing. Finding investments that create cash flow is hard."

I know," said rich dad. "Just hear what I am saying. Don't let greed and easy money interfere with becoming a rich and financially wise man. Never confuse capital gains with cash flow."

Cash Flow Is Harder

After 1971, prices increased, but wages did not keep up with inflation. At the same time, jobs were being exported overseas. Knowing something was wrong with our money and wanting to get rich quick, people began investing for capital gains.

Intuitively understanding that the dollar was becoming worthless, people stopped saving money and began investing in things that appreciated with inflation. People invested in art, antiques, old cars, Barbie dolls, baseball cards, and vintage wine—but the stock market and real estate were the most popular investment classes for capital gains investors. Many people became very rich borrowing money and investing in this way. Today, however, many of these same people are the new poor. This time, their bets didn't pay off.

In 1929, just before the market crashed, people were borrowing money to buy stocks on margin—basically taking out loans to buy stocks. They were betting on capital gains.

In 2007, people were again betting on capital gains with borrowed money—this time with houses and stocks. And that crash was just as devastating.

The Capital Gains Blues

In 2009, most of the investors who were crying the blues were investors who invested for capital gains. If they had focused on cash flow, they might not have been as affected by this crisis. They might not be so worried now about their retirement, sending their kids to college, or losing their job. Between 2007 and 2009, the stock market lost over 50 percent of its value—a value measured in capital gains.

According to Bloomberg.com, since January 2007, the Case-Shiller Home Price Indices in 20 big American cities had fallen every month over two years. In some cities, such as San Diego, Miami, and Las Vegas, the decline was as much as 33 percent. Recently, it was reported in the Arizona Republic that my city, Phoenix, earned the distinction of being the first major metro area where home prices had dropped over 50 percent from their highs. Again, Case-Shiller is measuring capital gains—the price of an asset at one particular time versus the price of that asset at another particular time.

Millions of baby boomers my age are praying that both the housing and stock markets will come back before they retire so they won't have to work through their retirement. But again, they are praying for capital gains. They are not actively taking control of their incoming cash flow. They are putting their faith in the market.

Beat Them At Their Own Game

My real estate investment company owns a lot of real estate in Phoenix. But my company isn't hurting. We're doing fine because we invest for cash flow. We rent apartments. We rarely flip properties. We beat the conspirators by playing the same game they play, the game of cash flow, the same game I learned from my rich dad while playing Monopoly.

Monopoly is not a game about flipping. Monopoly is not a game about buying low and selling high. It is not about diversification.

Monopoly is about focus, planning, patience, and long-term control. The first objective is to control one of the four sides of the board game. The second objective is to improve the properties on the side you control, adding green houses and eventually a red hotel. The ultimate investment strategy is to have only red hotels on your side of the board. Then you sit and wait as the other players round the corner hoping not to land on one of your properties. The final objective is to bankrupt the other players and take all their money. And even today, many people are going bankrupt in the real game of Monopoly.

I Would Have Been Richer

I could have made a lot more money in the short term if I had invested for capital gains or flipped real estate. It was hard to invest for cash flow while everyone else was investing for capital gains. Now, however, I appreciate rich dad's lessons more and more. I know why he insisted on teaching me to focus on cash flow and not to get sucked into the frenzy of buying low and selling high.

Most people understand that it's important to have cash flow coming in every month. The problem is they don't understand the difference between good cash flow strategies and average cash flow strategies.

Good cash flow strategies provide passive income that is taxed as little as possible and that you can control.

Average cash flow strategies provide passive income that is taxed in the highest income bracket and that you have little to no control over.

The following are some examples of average cash flow strategies:

- **Savings:** Interest from savings is a form of cash flow. Today, the interest rates on short-term bonds are less than zero. If you are lucky, a bank may pay you 3 percent interest on your savings. There are two problems with cash flow from savings. One is that the 3 percent interest is taxed as ordinary income—the highest tax possible, which means your 3 percent interest is really 2 percent net taxes. Second, the Federal Reserve is printing trillions of dollars to bail out the big banks. In the late 1970s, the bailouts were only in the millions. By the 1980s, bailouts were measured in billions. In 2009, the bailouts were in the trillions. This will result in inflation, and possibly hyperinflation. If inflation is higher than 2 percent per year, you actually lose money by collecting interest from banks in the form of savings account interest. Understanding the relationship between bailout money and inflation is one example of the importance of knowing history: By knowing a little history, you can understand how fast your savings can lose value. You get paid 3 percent (2 percent after taxes) on your savings as the central banks print trillions of dollars.

- **Stocks:** Some stocks pay dividends, which are a form of cash flow. Millions of retirees live on dividends from their stocks. The problem with dividends is that during this crisis many firms cut dividends. During the first week of April 2009, Standard and Poor's announced that 367 firms cut dividends by $77 billion in the first quarter of 2009. That was the worst payout since the S&P started tracking dividend payments in 1955. This meant the recession was spreading right where it hurt, to retirees who were once well off in the pocketbook.

- **Pensions:** Pensions are a form of cash flow. The problem is the federal Pension Benefit Guaranty Corporation (PBGC) shifted most of its $64 billion in assets from bonds to stocks and real estate, just in time for the crash. This means the geniuses behind the PBGC shifted out of cash flow from bonds, presumably because the income from bonds was perceived as too low, and into stocks and real estate, hoping for larger profits from capital gains. This means many pension plans are now in deep financial trouble. Additionally, the concept of the pension is ancient history for most people. Most companies do not provide a pension anymore, or have drastically reduced the range of their pension program. Now it is mostly government and labor union employees who can count on a pension. Most people have to figure out some other way to generate cash flow for their retirement.

- **Annuities:** Annuities are also a form of cash flow. Let's say you turn over $1 million to an insurance company. In exchange, the company agrees to pay you a percentage of interest on that money for the rest of your life. The problem is annuities are often backed by commercial real estate that you have no control over—commercial real estate and other financial instruments that were bought by large institutional-type investors, many of which are public companies, for capital gains and not for cash flow. The trouble with public companies investing for capital gains is that by standard accounting rules, they must mark down their assets to market and raise more capital to cover those losses. This hurts the insurance companies and your annuity returns—all you have to do is look at AIG.

Why Don't More People Play the Game of Cash Flow?

Years ago, I went to a conference on investing and listened to different speakers present on different investments. One speaker was a financial planner who was advising people to rebalance their stock and mutual fund portfolios, which to me is ridiculous. Rebalancing is another way of saying invest for capital gains.

He then said, "I know some of you have lost money in the market. But don't worry. The stock market will come back. Remember, on average, the stock market goes up approximately 8 percent per year, so I recommend you continue to invest for the long term."

I had to leave when I saw people in the audience nodding their heads in agreement with him. I wondered how people could be duped so easily. The conspirators need your cash flowing to them. That is why they train their salespeople (otherwise known as financial planners and stockbrokers) to say things like "the stock market goes up 8 percent per year". They use the lure of capital gains to draw your cash flow into their pockets.

Real estate agents use a similar sales pitch.

They often say, "You'd better buy now before prices go up." The idea of buying before prices go up is buying on the expectation of capital gains. Again, the salesperson uses the lure of capital gains to get your cash flow. That's the game. The moment you sign that mortgage, cash flows from you to them.

Are You Average Or Are You Excellent?

There are a number of reasons why most people invest for capital gains, and not cash flow. Some of the reasons are:

1. **Most people do not know the difference.**

2. **When the economy was growing, it was easy to play the capital gains game.** People automatically assumed their house and stock portfolio would go up with inflation.

3. **Cash-flow investing requires more financial sophistication.** Anyone can buy something and hope the price will increase. Finding cash- flowing deals takes knowledge of both potential income and expenses, and how to project the performance of the investment based on those variables.

4. **People are lazy.** They live for today and ignore tomorrow.

5. **People expect the government to take care of them.** This was my poor dad's attitude, and he died a poor man. For my poor dad, it was easier to expect someone else to take care of him.

Today, there are tens of millions of Americans, my fellow baby boomers, who are about to follow in my poor dad's footsteps. If you don't want to be poor, you need to know how to play the game.

The way to beat the conspiracy is to first know the name of the game, and the name of the game is cash flow. Once you know the name of the game, you need to learn the terminology - the language of money.

One way to learn the language of money is to play my board game, CASHFLOW, a board game and an electronic game that will prepare you for the real game of cash flow that happens all around you, every hour of the day.

As we discussed, two very important terms are cash flow and capital gains. In simple terms, 90 percent of the people play the game of capital gains. Only 10 percent play the conspirators' game of cash flow. Therefore, only 10 percent win. Do you want to be a winner or a loser? Do you want to be average or excellent?

While playing Monopoly®, rich dad would remind me that many people also look for the glitter in real estate. They want to splurge on Boardwalk and Park Place, but the true wealth is from owning the other properties and loading them up with houses and hotels.

"It's not the glitter that counts. It's the cash flow." he'd say.

In fact, in a Harvard Business Review article entitled "Everything I Know About Business I Learned from Monopoly," Phil Orbanes says, "Casual players don't know this, but the 28 properties around the Monopoly board are not equally valuable in terms of ROI.

Boardwalk and Park Place, which many regard as the most precious, actually are not. It turns out that the orange and red properties have the highest ROI and are the best properties to own."

When I look for real estate investments, I generally do not go to the new-home subdivisions where there are helium balloons, large eye-catching signs, flashy model homes, and a sales trailer offering easy financing plans. I know these marketing ploys are to attract potential homeowners who are seeking emotional satisfaction. When I look for real estate, I am often looking in older neighborhoods at unattractive buildings, many with major problems. Often that is where the highest-yielding investments are, but not always. I have bought brand-new real estate in hot new areas that turned out to be a financial home run. I do know that sometimes things that glitter are gold.

Again, it is financial education—being able to read financial statements, the deal, the trends, and the needs of the buyer and seller, that can turn glittery fool's gold into glittery real gold. That is financial alchemy.

The point is, millions of people, rich and poor, are in financial trouble because they are fools for the glitter. In just a few years, millions of aging people throughout the world will find out they are in financial trouble because their DC pension plans are invested in glitter, but not in gold.

Learning the Lingo

In the spring of 1999, I was scheduled to give a talk to a group of approximately 250 bankers in Los Angeles.

Since I was to be the first speaker in the morning, I flew in the night before. After having breakfast, I sat in my hotel room and scratched my head as to what I could say to this group of bankers. My standard talk about financial statements, financial literacy, and the differences between an asset and a liability seemed inadequate for this group. Since they were not just ordinary bankers, but mortgage bankers, I assumed they would know the financial basics I most often talk about.

Or at least I hoped they did.

My talk was scheduled for 9:30 that morning. It was now 8:00, and I was still at a loss for an angle or a new idea appropriate for the group. Sitting at the desk in my hotel room, I glanced at the complimentary morning newspaper the hotel had provided. On the front page was a photograph of a happy couple sitting in their golf cart.

The bold headline over the picture read, "We Decided to Retire Early."

The article went on to explain that this couple's 401(k) retirement plan had done so well over the past ten years in this booming stock market that they decided to retire six years earlier than planned. He was fifty-nine years old and she was fifty-six. The article quoted them as saying, "Our mutual funds have done so well we realized one day we were millionaires. Instead of working for six more years, we scaled back, sold our home, bought a smaller home in this retirement village, put the extra money from the sale of our house in a high-yield certificate of deposit, reduced our expenses, and now we play golf every day."

I had found the subject for my talk.

Finishing the article, I showered, dressed, and headed down to the waiting mortgage bankers. At exactly 9:30, I was introduced and brought up onstage. Lifting the newspaper up in the air, I opened my talk by pointing to the picture of the newly retired couple and repeating the headline, "We decided to retire early." I then stated the couple's ages, 59 and 56, and read a few comments from the article.

Putting the paper down, I said, "My wife, Kim, and I also retired early. We retired in 1994. I was forty-seven and she was thirty-seven."

I looked around the room and allowed the difference in ages and dates to sink in.

After a silence of about ten seconds, I continued asking, "So let me ask you this: How is it that I could retire 12 years earlier than he could? How could my wife retire 19 years earlier? What made the difference?"

The silence was deafening.

I was off to a bad start. I knew it was early and I knew I was asking the audience to think instead of just listen. I knew I probably sounded arrogant and cocky, comparing my early retirement to the couple in the newspaper.

Yet I wanted to make a point to this group and it was too late to turn back. I felt like a stand-up comedian who had just told his best joke, and the audience was not laughing.

Pushing on, I asked, “How many of you plan on retiring early?”

Again there was no response. No one raised a hand.

The discomfort in the room was growing. I was dying onstage. I knew I had to do something quickly. Looking out on the group, I could see that most of the group were younger than I was. The few that were my age were not impressed with my talk about retiring young.

Quickly I asked, “How many of you are under forty-five?”

Suddenly there was life.

There was a response. Slowly hands were raised from all around the room. I estimated that about 60 percent of the group raised their hands, indicating they were younger than forty-five. It was a young crowd, relative to me at least.

Changing my tactics, I then played to this group, asking, “How many of you would like to retire in your forties and be financially free for the rest of your life?”

Now the hands were shooting up with more enthusiasm. I was beginning to communicate a little better, and the audience seemed to be coming to life. The participants of my age and older began to squirm as they looked around at their younger peers, many of whom had their hands in the air, indicating they did not want to grow old in the industry. Sensing the discomfort of those my age and older, I realized I needed to say something quickly to not alienate this group.

Smiling, I paused as the hands came down.

Looking at the older bankers in the group, I said, “I want to thank the mortgage bankers of this world because you were the ones who made it possible for me to retire early—not my real estate broker or my stockbroker, not my financial planner, and not my accountants. It was you, the mortgage bankers of the world, who made it possible for me to retire approximately 20 years earlier than my father.”

Looking out at the audience, I could tell that some of the uneasiness was dissipating, and I could now continue on with my talk. My acknowledgment of their industry seemed to have helped. I estimated I now had about 80 percent of the audience's attention.

Continuing, I repeated the question I had asked earlier, “So how is it I could retire earlier than the couple in the newspaper, and how did you mortgage bankers help me to do so?”

Again there was silence.

I began to realize they did not know how they helped me. Then, even though there was the same dead silence, at least they seemed to be more awake than they were a few minutes earlier. Deciding to stop asking a question they were hesitant to answer, I continued. Turning to my flip chart on stage, I wrote in big bold letters:

Debt Equity

Returning to the audience, I pointed to the word debt and said, "I was able to retire early because I used debt to fund my retirement. And this couple in the newspaper, the people with the 401(k), used equity to fund their retirement. That is why they took longer to retire."

Pausing for a moment, I let what I had just said sink in.

Finally a hand popped up and asked, "So you're saying the guy in the newspaper used his money to retire and you used our money to retire?"

"Correct," I said. "I was using your money to get deeper in debt, and he was trying to get out of debt."

"So that's why it took him 12 years longer than you," another person said. "It took him longer because he used his money, his own equity to retire."

I smiled, nodded my head, and said, "And for me, retiring at age 47 gave me 18 years of extra life when compared to someone who retires at age sixty-five. And how much is 18 years of life worth to you, 18 years of your youth? For my wife, it was 28 years of extra time to enjoy her youth. How many of you would rather retire early so you can enjoy your youth, your vitality, and the freedom to do whatever you want with all the money you need?"

Hands went up all over the room.

There were now more smiles attached to those arms. People seemed to be coming to life. Yet, as expected, there were those sitting with their arms folded across their chests and legs crossed over their knees. My talk did not seem to be too well received by those individuals. The cynics and skeptics wanted to be cynics and skeptics. I did not seem to be reaching them. At least I was saving myself from a very bad start and some of the group was coming over to my side.

A young man in the front row raised his hand and asked, "Would you mind explaining a little more about how you retired early using debt, and how the other guy used equity?"

"Certainly," I said, happy to have the opportunity to explain further. Picking up the newspaper and pointing to the picture, I said, "This person retired six years ahead of schedule, if age 65 is the benchmark for retirement, because the stock market did well. So he did well because he invested his own money into the market. How much better would he have done if he had borrowed your bank's money and invested your money into the same market?"

A rush of uneasiness went through the room.

What I had just said had disturbed many in the audience.

The young man, now with a puzzled look on his face, then said, "But we wouldn't lend him our money to invest in the stock market."

"Why not?" I asked.

"Because it's too risky," he said.

Nodding, I said, "And because it's too risky, this retiree had to use his own money, his equity. His retirement plan, his 401(k), did well and so did his own stock picking. He did well because the market did well. The stock market did well because millions of people, just like him, were doing the same thing at the same time, so he retired early. But he took longer because he basically used his own money, his equity, to buy equity in other investments. Interestingly, he invested in investments your industry generally does not lend money to invest in because of the risk factor. You bankers don't lend people money to speculate in the stock market, do you?"

Most in the room shook their heads.

"So are you saying he got lucky?" another person asked.

"Well, he was in the right place at the right age and in the right cycle of the market," I said. "If and when the trend reverses, he might wish he had not retired so early."

"And you did it differently. You used our money to invest in what?" asked another participant.

"Real estate," I said. "What else do you lend money on? You are mortgage bankers, aren't you? You're not investment bankers, are you?"

The young man nodded his head and said quietly, "We are mortgage bankers and we lend money for real estate, not stocks, bonds, and mutual funds."

"But didn't the stock market go up in value more than real estate in the last ten years?" asked a young woman sitting a few rows back from the front row. "My 401(k) did far better than most of the real estate investments I have seen."

"That may be true," I replied.

"But your 401(k) increased in value because of market momentum and capital appreciation. Do you make it a policy to invest in market momentum or possible capital appreciation?"

"Not as a policy," said the young woman.

"Neither do I," I said. "I do not invest for capital appreciation only. The values of my properties do not need to appreciate in value for me to make money, although some have appreciated greatly in the same period of time and none has gone down in value like many stocks and mutual funds have."

"So if you don't invest for capital appreciation, what do you invest for?" asked the young woman.

"I invest for cash flow," I said quietly. "How much cash flow per month does your 401(k) put into your pocket to spend each month?"

"Well, nothing," said the young woman. "The purpose of my retirement plan is to have all the capital appreciation grow tax-free so all my money stays in my retirement account. It is not designed to give me monthly cash flow."

"And do you own any investment real estate that gives you monthly cash flow plus tax breaks?" I asked.

"No," said the young woman. "All I have is an investment plan that invests in mutual funds."

"And you're a mortgage banker?" I asked with a teasing smile.

"Let me get this straight," said the young woman. "You borrowed our money to buy your real estate. Then each month, that real estate returns cash flow to you. You and your wife were able to retire early because you have cash flow while the rest of us are hoping for the capital appreciation of our mutual funds and hoping to retire later in life, hoping the market does not crash when it is our turn to retire. In other words, we helped you retire early, but we do not help ourselves?"

"That's one way of looking at it," I replied. "And that is why I am here to thank you and your industry for contributing to my retirement fund. You have contributed millions so I could retire early. I would like to have you think about doing the same for yourself.

And one more thing. When the older couple retired, they sold their house and got a smaller house. They downsized their life. When I retired, my wealth kept growing and my lifestyle kept improving. That is a very important difference."

My time was soon up and I received a courteous applause as I left the stage. The room was now awake, and there seemed to be some excitement about what I had to say, especially from the young people. As I walked through the crowd shaking hands, I got a chance to listen to some of the comments about my talk.

Then, even though they were mortgage bankers, I could still hear the usual comments I always hear from any crowd, such as:

- "What he says is far too risky."
- "I would never lend him any money."
- "He doesn't know what he is talking about."
- "You can't do that today. The market is different."
- "He got lucky. Just wait till the market crashes and he comes begging to us on his knees."

- "I don't fix toilets. That is why I don't own any real estate."
- "The real estate market is overbuilt. It will soon crash."
- "You know how many guys like him have been wiped out in real estate?"
- "If his debt is so high, I wouldn't lend him any money."
- "If he is retired, why is he talking to us?"

The Power of Cash Flow

To follow in my footsteps, if you plan on creating a plan to retire young and retire rich, you may need to update your vocabulary.

If you change your vocabulary, you may speed up your ideas.

For example:

Slow Words: High-paying job
Fast Words: Cash flow

My poor dad always advised: "Get a high-paying job."
My rich dad always advised: "You want cash flow from assets."

Finding a high-paying job may seem like the fast way to get rich at the start, but in most cases it is the slow way to become rich in the end. Remember my poor dad earned more money than my rich dad at the beginning of their careers, but by the end of their lives, the gap between their incomes was as wide as the Pacific Ocean.

In fact, very few people ever become rich via a job. Then, even a high-paying one. The following are some of the reasons why cash flow from assets is better than income from a job.

There are three different types of income:

- Ordinary income
- Portfolio income
- Passive income

Ordinary income, in most cases, is income that comes from a person's labor or work.

Portfolio income, in most cases, is income from paper assets such as stocks, bonds, and mutual funds.

Passive income, in many cases, is income from real estate.

As always, before making any financial decision, it is very important to have competent professional advice on any matter involving taxes. What may be legal tax planning for one person could be a tax violation for someone else. The point of this section is to know the difference words can make. There is a substantial tax difference between ordinary income and passive income. As far as leverage goes, taxes for most people are reverse leverage or negative leverage.

A person who works hard for ordinary income has to work at least twice as hard as someone who works hard to earn passive income (aka cash flow). Working for ordinary income is like taking two steps forward, and then taking one step back.

If you do not fully understand the terms appreciation and depreciation, do not worry. It took me a while to fully understand them. If you really want to understand them better, you may want to ask an accountant or a professional real estate investor to explain the concepts to you.

Maybe a story will help...

The other day, a television program ran a story about high school kids learning how to invest in the stock market.

One of the students being interviewed said, “I made a lot of money because I bought shares of XYZ company and the price of those shares went up.” In other words, he was playing the market in the hopes of capital gains or appreciation in the value of the shares he picked.

When most people say, “Our home is a good investment,” they say that because they expect their house to appreciate in value.

I hear friends say statements such as, “I bought a lot in this new golf-course community. It’s a good investment, and I expect the lot will double in value in five years.”

To them, such returns are a good investment, and hopefully they will realize a doubling of their money in five years. Rich dad taught his son and me to use different words.

When it came to buying any investment, he always said, “Your profit is made when you buy, not when you sell.”

In other words, he never expected his investment to appreciate in value.

If it did, to him, appreciation was a bonus. Rich dad invested for immediate returns on his investment, or *cash flow.*

He also invested for a thing he called “phantom cash flow” - more commonly known as depreciation. (An example of depreciation of a building was given in an earlier chapter.)

He loved immediate cash flow and depreciation because he did not have to wait for his investment to appreciate in order for him to make money. He would say, “Waiting for a stock or piece of real estate to appreciate in value is too slow and too risky.”

The point is this: if you are waiting to make money sometime in the future, your plan is a slow plan because you are using slow words, which lead to slow ideas.

Remember: “Your profit is made when you buy, not when you sell.”

I meet so many people who buy a piece of real estate, lose money on it each month, and say to me, "I'll make my money back when the value of the property goes up and I sell it."

In Australia, many people buy property, lose money on it every month, and think it is a good investment because the government gives them a tax break for losing money. In my opinion, that is a loser's way of thinking.

I often ask them, "Why not buy a property that makes you money every month *and* get a tax break every month."

The response I often get back is, "No, my accountant told me to look for a property that costs me money every month and gives me a tax break." Talk about choosing to board the slow and risky train rather than the fast and profitable train.

Are You Investing Or Gambling?

Financial intelligence begins with knowing what you are investing for. In the world of money, there are two things investors invest for: capital gains and cash flow.

1. Capital gains.

So many people think investing is risky is because they invest for capital gains. In most cases, investing for capital gains is gambling, or speculation. When a person says, "I'm buying this stock, mutual fund, or piece of real estate because I think it will go up in value," he or she is investing for capital gains, an increase in the price of the asset. For example, if I had purchased the $17 million apartment house hoping I could sell it for $25 million, then I would be investing for capital gains. Not only would I be gambling, investing for capital gains often means a tax increase - this is not a bet I want to take.

2. Cash flow.

Investing for cash flow is a lot less risky. Investing for cash flow is investing for income. If I put savings in the bank and receive 5 percent in interest, I am investing for cash flow. While interest is low-risk, the problem with savings is the return is low, taxes can be high, and the dollar keeps losing value. When I purchased the 300-unit apartment house, I was investing for cash flow. The difference is I was investing for cash flow using my banker's money for a higher return on investment and paying less in taxes. That is a better use of leverage.

What Are You Investing For?

Most financial advisors recommend that a person invest in growth funds when he or she is young. Investing for growth is investing for capital gains. They advise older investors to then shift their growth funds into income funds or annuities. In other words, invest for cash flow when you are older. They believe cash flow is less risky and more certain.

Three Types Of Investors

When it comes to capital gains or cash flow, there are three general types of investors. They are:

Those Who Invest Only For Capital Gains

In the world of stocks these people are called traders, and in the real estate market they are called flippers. Their investment objectives are generally to buy low and sell high. When you look at the CASHFLOW Quadrant, traders and flippers are actually in the S quadrant, not the I quadrant. They are considered professional traders, not investors. On top of that, in America, traders and flippers are taxed at the higher S-quadrant tax rates and do not enjoy the benefits of the tax breaks the I quadrant receives.

Those Who Invest Only For Cash Flow

Many investors like savings or bonds because of the steady income. Some investors love municipal bonds because they pay a tax-free return. For example, if an investor buys a tax-free municipal bond paying 7 percent interest, the effective return on investment (ROI) is the same as receiving a 9 percent taxable return. Generally, when people invest for cash flow using real estate they are renting out buildings. These building can be single-family homes, duplexes, apartment buildings, commercial buildings and even malls.

I have not discussed much regarding commercial real estate investments but, many investors love triple net leases (NNN). With NNNs, investors receive income without the expenses of taxes, repairs, and insurance. The tenant covers those costs. In many ways, a triple net lease is like a municipal bond, because a lot of the income can be tax-free or tax-deferred.

While I love triple net properties, as expected, the trouble is finding a good property with a good tenant willing to pay a high return. Today, as I write, most NNN properties are only paying about a 5 percent to 6 percent return. Not that exciting. The good news is if I dig deeper, I might be able to find a property with a much higher return, all the while using more leverage and my bank's money to lower my risk, which is why I prefer triple net real estate over tax-free municipal bonds.

This leads us to the third type of investor.

The Investor Who Invests For Capital Gains As Well As Cash Flow

While most of my investing is centered around cash flow, it was not always the case. I used capital gains in the beginning. There may come a time when I use capital gains again. For example, a time may come when the value of my apartment complexes is so high that I contemplate selling. If, I have another, better deal to move the money from a sell into, then I will look very hard at selling for capital gains.

What i need to make clear is, while my day-to-day strategy is focused on cash flow, if the timing is right I will sell for capital gains. I do not get lazy and only focus on one type of deal or strategy. As a professional investor I need to look at every deal and determine the best strategy for that deal.

Years ago, old-time stock investors invested for both capital gains and cash flow. Old-timers still talk about the price of a stock going up as well as paying the investor a dividend. But that was in the old economy, the old capitalism.

In the new capitalism, most paper investors are looking for the quick buck, to make a killing. Today, the big investment houses are hiring the smartest whiz kids out of college and using the power of supercomputers and computer models to look for the slightest market patterns they can exploit. For example, if the computer picks up a 1 percent differential, let's say in tech stocks, the investment house will bet millions of dollars, hoping to gain 1 percent on millions of dollars in a few hours.

This is very high leverage, and very risky.

These computer models also cause a lot of the volatility in the markets and often cause crashes. When the stock market announces that program trading has been halted, it is talking about these computer programs being halted. The markets crash if the computers say sell. If the computers say buy, the markets boom, and then they crash. In other words, prices can go up or down for no fundamental or business reason at all.

A stock price may have no relationship to the value of the company because the computers created an artificial supply or demand. If you recall the dotcom era, companies that were not companies, but rather just good ideas, were valued at billions of dollars, and companies that were really valuable had their share prices trashed when the dotcom boom busted.

As an old-time investor in this new era of capitalism, I must be smart enough to invest for capital gains, cash flow, leverage of debt, and tax advantages, as well as be above the turmoil the whiz kids and supercomputers cause in the marketplace.

For instance, I recently purchased a stock, even though I do not have control, because the company, an "old and boring" Industrial Age company, historically pays a steady 11 percent dividend.

When the share price dropped in the recent market crash, I bought the stock because the price of the cash flow became cheaper.

So I do occasionally buy paper assets, but I tend to buy only for cash flow. Being a little guy and not having control over the company, I do not use leverage. I only invest with cash I can afford to lobe if I'm wrong. If this particular stock goes up in price, I may sell because I like investing for both cash flow and capital gains. My ROI, return on investment, goes up if and when I can receive both cash flow and capital gains.

Play By The New Rules And You Might Even Become Rich

Don't diversify.

Take control of your money and focus your investments. During the last financial crisis, I took a few hits, but my wealth remained intact. That is because my wealth is not dependent upon market values going up or down (aka capital gains).

As I just mentioned, I invest *almost exclusively* for cash flow.

For example, my cash flow decreased a little when the price of oil came down, yet my wealth is strong because I still receive a check in the mail every quarter. Then, even though the price of the oil stocks came down, I'm not worried because I receive cash flow from my investment. I don't have to worry about selling my stocks to realize a profit. The same is true with most of my real estate investments.

I invest for cash flow in real estate, which means every month I receive checks—passive income. The people who are hurting today are real estate investors who invested for capital gains - the property flippers.

In other words, since most people invested for capital gains, counting on the price of their stock investments or their home to go up in price, they are in trouble today.

When I was a boy playing Monopoly®, I learned the difference between cash flow and capital gains.

Again, for example, if I owned a property with one green house on it, I got paid $10 a month in rent. If I had three houses on the same property, I received $50 a month in rent. And the ultimate goal was to have one red hotel on the same property.

To win the game of Monopoly, you had to invest for cash flow—not capital gains.

Knowing the difference between cash flow and capital gains at the age of nine was one of the most important lessons my rich dad taught me. In other words, financial education can be as simple as a fun game and can provide financial security for generations—even during a financial crisis.

Today, I do not need job security because I have financial security. The difference between financial security and financial panic can be as simple as knowing the difference between capital gains and cash flow. The problem is that investing for cash flow requires a higher degree of financial intelligence than investing for capital gains.

It is easier to invest for cash flow during a financial crisis.

So don't waste a good crisis by hiding your head in the sand! The longer this crisis lasts, the richer some people will become.

I want you to be one of them.

Today, one of the new rules is to focus your mind and money, rather than to diversify. It pays to focus on cash flow rather than capital gains because the more you know how to control cash flow, the more your capital gains increase, and so does your financial security. You might even become rich. It's basic financial education taught in the game of Monopoly and my educational game, CASHFLOW, which has been called Monopoly on steroids.

These new rules - learn to spend rather than save and focus rather than diversify - are just two of the main aspects of financial intelligence. The point of this book is to open your eyes to the power you have to control your financial future if you have the proper financial education.

Our educational system has failed millions of people—even the educated. There is evidence that our financial system has conspired against you and others. But that is ancient history.

Today, you control your future, and now is the time to educate yourself—to teach yourself the new rules of money. By doing so, you take control of your destiny and hold the key to playing the game of money according to its new rules.

CHAPTER 14:

Creating Long-Term Generational Wealth Through Real Estate

Your kids, and your kid's kids can benefit from real estate.

On January 24, 2011, on the TODAY show, Consumer Reports and Jean Chatzky (their resident personal finance expert) offered the following advice.

It is the same advice they've been dishing out for years:

- Live modestly.
- Have a budget and open a 401(k) retirement plan.
- Catch up. (In other words, save, save, save.)
- Pay off debt.
- Work longer; retire later.

I would never follow this advice.

Not only is it bad advice, it is also depressing. Who looks forward to living modestly and saving? On top of being depressing, this advice *terrifies* me. While this may sound like great guidance, especially for the financially uneducated, this is terrible advice.

This is why a retirement plan, such as a 401(k), is the worst way to invest or set you and your loved ones up for long term generational wealth.

TIME magazine put out an article years ago titled, "Why It's Time to Retire the 401(k)." In it, they showed why the 401(k) is a disgrace due to the way it destroys people's wealth. And in 2019 and beyond, the people following the advice from the Today show will be hurt the most.

They will be whipped by ups and downs in the global economy and crushed by higher taxes. They will find life very expensive as inflation goes through the roof. A majority will wind up poorer as their investments in the stock market are lost to market crashes.

The greatest tragedy of all is that people who follow this old advice will miss out on the greatest opportunities in history.

Tremendous wealth will be generated in the next few decades, but not for those following that obsolete advice.

Those following the old advice will watch in frustration as the rich become even richer, while life becomes tougher for them and their loved ones…

...especially as they near retirement.

Poor Dad's Advice

When I asked my poor dad for advice, he recommended that I follow in his footsteps, which would be to go back to school, get my master's degree, get my PhD, and then get a job with the government.

The problem was that in 1973 my dad was 54 years old, the former superintendent of education for the State of Hawaii, a former Republican candidate for lieutenant governor of Hawaii... and unemployed.

He had no long-term plan, no cash flow, nothing to offer me, and nothing to retire on.

My dad was unemployed because he resigned from the superintendent of education position to run on the Republican ticket against his boss, who was the governor (and a Democrat). When Judge Samuel King and my dad lost the gubernatorial election, the governor informed my dad that the price for his lack of loyalty was to never be allowed to work in state government again.

My dad, although highly educated, could not survive in the real world outside of the educational system. Knowing he could not find a paying government job, my dad took his retirement savings, bought an ice cream franchise and lost it all when his ice cream business failed.

In many ways, it was my poor dad who gave me a glimpse of the future - not for his generation, but for mine.

When he recommended that I follow in his footsteps, I knew whose guidance I would rather follow. After leaving my poor dad's home, I drove to Waikiki to my rich dad's office and asked for his advice.

Rich Dad's Advice

My rich dad told me that a comfortable retirement and long-term wealth all depend on cash flow.

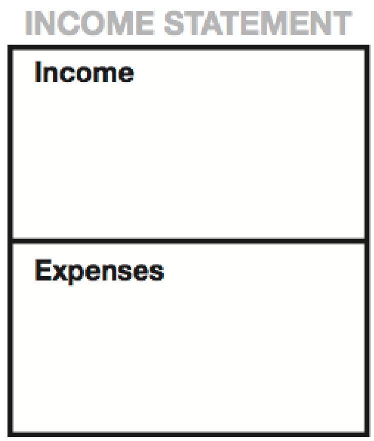
"Cash flow is important because it is the primary control an entrepreneur or investor wants control over."

"Control?" I said.

"Yes, control" he replied. "The reason I love real estate and buying or building businesses is because I have control. Most investors think investing is risky because they invest in investments they have no control over—investments such as savings, stocks, bonds, and mutual funds."

And of course he was right.

When you look at the diagram of a financial statement, you will see why control of cash flow is so important to professional investors and business owners.



The sign of a high financial IQ is high cash flowing into the income column.

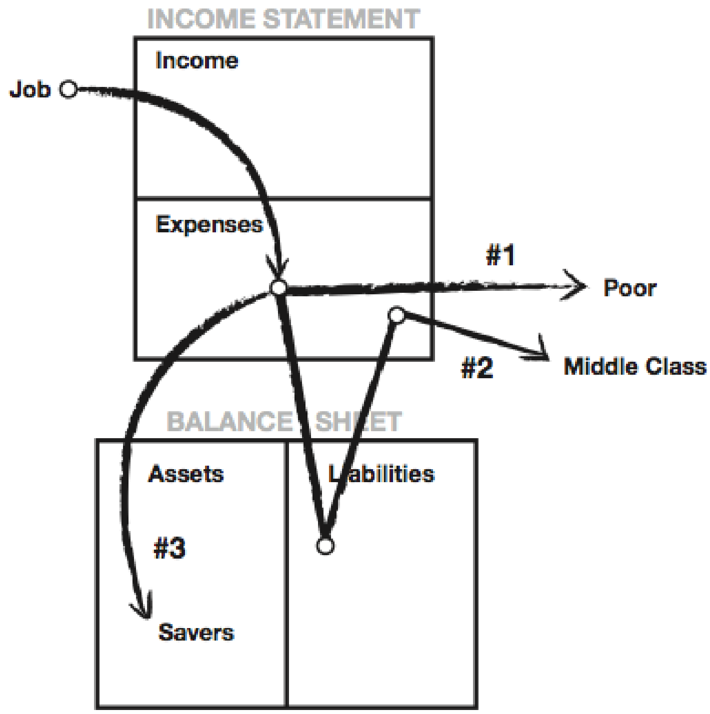
The sign of a low financial intelligence is excessive cash flowing out through the expense column.

America as a country and many Americans are in financial trouble because they have not been able to increase the cash flowing into their income column and have lost control over the cash flowing out of their expense column.

Also, rather than creating assets (like real estate), they continually create more liabilities (like buying cars and "toys"), which accelerates the cash flowing out through the expense column. Someone who has excessive credit card debt, takes out a home equity loan to pay off the credit cards, and then goes out and gets into more credit card debt is an example of someone who has lost control.

Interestingly enough, my rich dad said the expense column was the most important of the columns. He said, "Most people spend and make themselves poor. If you are going to build 'generational wealth', you need to know how to spend to make yourself rich."

The Following Diagram Will Explain Why He Said This:



These are the three basic controls of the expense column.

One of the reasons our country struggles and millions of people struggle is because all they have is cash flow #1 and cash flow #2. If you want to be rich, retire with more than you need, and pass on your wealth to your loved ones, you need to have cash flow #3.

The cash flow arrow #1 gets cash in from a job, then spends it all. I could be rent, food and other necessities. The point is not to judge what they are spending their income on, it is to show you the behavior of the poor. The other point of importance is where their income is coming from. It is only coming from a job. There have been numerous examples in this book of making money without having money. This can be done, but the poor don't know how or don't have the courage or drive to make it happen.

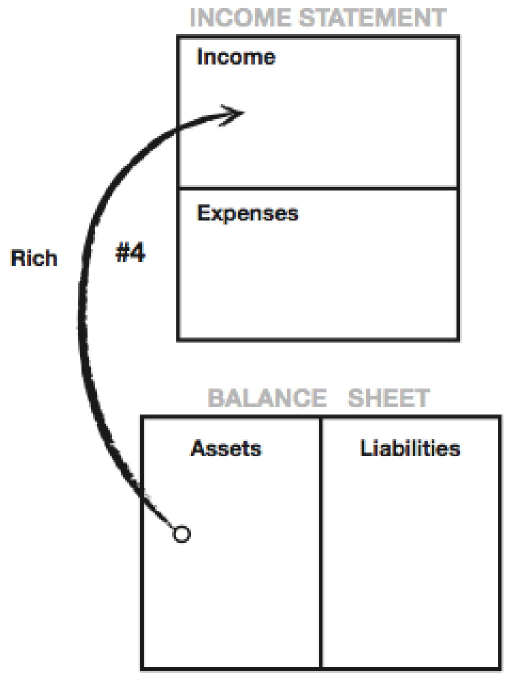
The cash flow arrow #2 is the path of the middle class. Again, the only income is from a job. This time however, not all of the money is going out immediately. Some of the money is first going into the liabilities column. These are things like a mortgage, or a car loan or credit card payment. The middle class have been tricked into thinking they are buying assets but in reality they are buying liabilities and preventing themselves from financial freedom.

The third cash flow arrow is simply people who believe that saving money is the answer to freedom. As I mentioned earlier the dollar is basically worthless and everyday it buys less and less. Saving looks like a good idea but you cannot save yourself to riches.

USA Today conducted a survey years ago and found that the greatest fear in America was not terrorism but the fear of running out of money during retirement.

Could it be because most financial advisors and people have a saver's mentality? Cash flow #3 is a diagram of a saver's mentality. To become very rich and not live below one's means, a person needs cash flow arrow #4.

This is the arrow rich dad taught me.

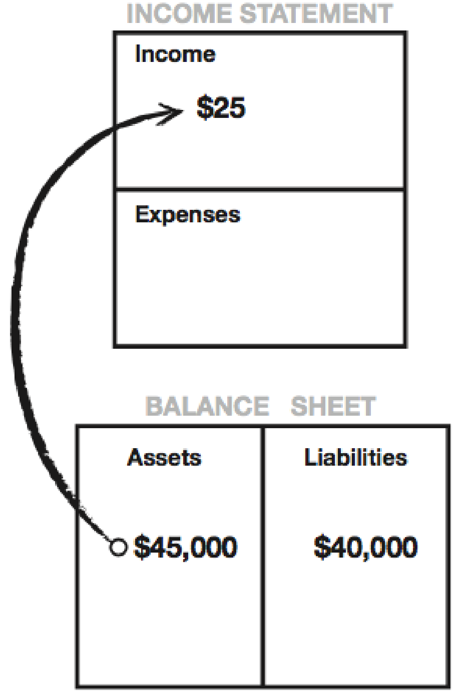


Whether or not I work, cash keeps flowing in from my assets.

The harder I work at adding to this asset column, the more the money keeps pouring in. Both my wife and I have more than enough money flowing from cash flow #4. This is why we do not have to work, but we choose to continue to work hard, adding more assets, which makes us richer.

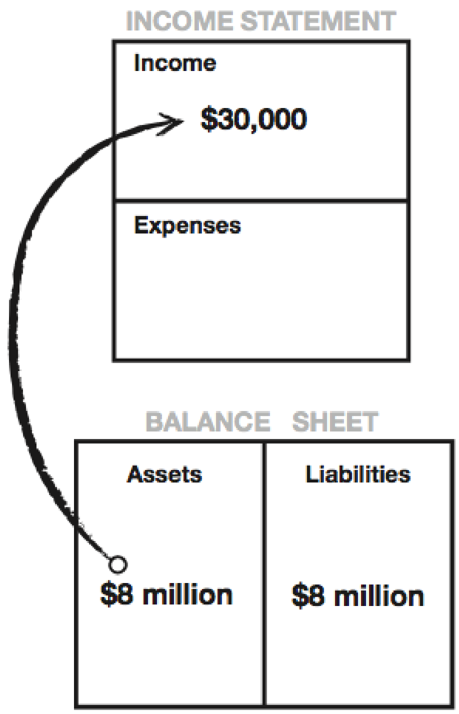
Let me give you an example of my wife's activities.

In 1989, Kim's first investment was a $45,000 two-bedroom, one-bath home in Portland, Oregon. Her financial statement looked like this:



After looking at thousands of deals and actually buying maybe 25 of them, she made the following investment in 2004: She purchased a commercial property for approximately $8 million and put down $1 million, which she borrowed, so it was 100 percent financed by debt.

Her net cash flow looked like this:



In other words, every month she earns $30,000 net income.

Also, this income, because it is passive income, is taxed at a lower tax rate than that of someone who earns wages of $30,000 a month.

This is an exceptional investment. While such investments do exist, they are rare. But being financially literate, being able to have X-ray vision, has its rewards. If you do the math, the return on this investment is infinite. It sure beats the 10 percent returns the financial planners brag about.

This is how people build wealth that lasts for generations.

Wealth they can pass on.

Real estate investors derive higher returns on their money because creativity is allowed in real estate (and in business). Whereas creativity and controls are, for the most part, taboo in savings, stocks, bonds and mutual funds.

Back in 2005, Kim found another investment.

This time she had to put down a million dollars of her own money, but the 2005 investment also pays her a net $30,000 a month. Today, her passive income - which is income without working - is well over a million dollars a year.

Baby Boomers In Trouble?

The baby-boom generation, that group born between 1946 and 1964, was, in many ways, a very fortunate group.

They were born just as America became the dominant world power militarily *and financially*. However, they are now witnessing the decline of America, if not militarily, at least financially. The baby-boom generation is the *last* generation of the Industrial Age and the first generation of the Information Age. They are a transitional generation, and this transition is causing an even greater divide between boomers who have money and boomers who do not.

Aging may not be easy for boomers who followed the rules and values of the Industrial Age. Upon leaving school, many of these boomers went to work in Industrial Age businesses such as the auto industry and the airline industry. There are significant financial challenges facing boomers in these industries today, just as they prepare for retirement.

The boomers who made the transition to Information Age rules and values will have a better chance of aging with grace and retiring with affluence. Boomers in the auto and airline industry who went to work for companies like Microsoft and Apple have done extremely well.

As this group grows older, though this division of wealth between Industrial Age boomers and Information Age boomers will become even more apparent. How they will fare in the next few years may depend upon which rules of money they followed—the rules of the Industrial Age or the rules of the Information Age.

Just as the first wave of baby boomers was leaving college, the world started changing. First we had the Vietnam War—a costly war that divided and nearly tore our country apart. Then in 1971, the United States came off the gold standard. In 1973, the first gas crisis hit. And then in 1974, ERISA was enacted.

In 1971, just as many of the first baby boomers were getting out of college, gold was $35 an ounce. Now as I'm writing this at the end of 2018, gold has hit almost $1,300 an ounce. That is an example of how much the dollar has lost in buying power.

In 1971, many of the baby boomers were getting married and buying homes. Back in 1968, my father paid $50,000 for his home. Today, the same home is worth nearly $3 million. While this increase in value is good for the baby boomers, it makes it tough on their kids and grandkids to be able to afford a home of their own.

Some baby boomers now have a tough time getting their kids to move out of the house.

Many baby boomers do not have pensions due to the changes that began in 1974. Many boomers do not have the plans their parents did, and if they do, many of those plans are in trouble. Having received no financial training in school, they didn't understand the difference between a savings plan and their parents' pension plan.

So what'd they do?

Millions simply turned their money over to "financial experts" and had no idea what was happening with their money. In 2000, the stock market crashed and woke many of those boomers up to the reality that their retirements may not be that secure. Many found out that their "experts" had even less financial training than they did.

In 2006, after buying huge gas-sucking SUVs, boomers were once again hit with an oil crisis. This time it is a real one, not a politically contrived one. Back in 1973, oil was about $3 a barrel. It is now around $71 a barrel, and may go even higher in the near future.

The increase in the price of oil means those counting on living on fixed incomes will find those fixed incomes will not buy as much. What will happen to their retirement savings if the price of gasoline goes to $10 a gallon?

And we already know about Social Security and Medicare. I hope you aren't counting on the government to take care of you. It's estimated that 80% of the baby boomers are not going to be able to afford a comfortable retirement.

Many are in trouble simply because they followed their parents' financial plans.

And this is exactly why real estate can save you.

Getting Rich Is Predictable

My rich dad used an apple grower to explain predictability.

He told me the story of an apple grower who started with one acre of apple trees:

"Planting that first acre was hard. The farmer did not have much money, and the apple trees needed time to grow. After a few years, apples appeared, and the farmer sold them. With his profits, he bought two more acres and planted more trees. Soon he had over a hundred acres of apple trees, all producing apples. It started slowly, but he knew if he kept doing what he was doing, he would soon be a very rich man."

Though this example was a very simple one, it served me well.

"Yes, but what about bugs or drought?" some might ask.

It's a valid question...and successful business owners don't count on everything going perfectly.
For example, all store owners know that there will be theft by both customers and employees. A successful business will factor in reserves for these losses in their projections and build systems to control and minimize those losses.

Now I hear some cynics saying, "Yes, but if you plant too many trees and produce too many apples, the price of apples will come down."

Yes, this is also true.

Bringing prices down is the object of competitive capitalism. Without competitive capitalism, we would not enjoy a higher standard of living at an affordable price.

My point is, once you understand predictability, you will see it everywhere. You can see it every time you pass a McDonald's. You can see predictability every time you see a pair of Levi's jeans. When you drive up to a gas station to fill your car with gas, it is predictability in action. You see it even playing *Monopoly®'.*

If you recall, one house pays you so much.

If you add two houses, you earn more, and if you convert four houses into a red hotel, you earn even more. Once you understand predictability, you will see it everywhere. And wherever you see predictability, you will understand why someone can make a lot of money without much risk.

Now you may better understand why I become frustrated when I hear people say, "Real estate investing is so risky." Or when I hear a financial planner tell someone that the safe thing to do is invest in savings and mutual funds. To me, it just shows a lack of financial training and a low financial IQ.

Donald Trump made his billions not by building just one building; he built many buildings or he built a building with hundreds of condominiums in it and sold them. His formula for success fits the formula I just described.

He leverages, controls, creates, expands, and predicts.

While there is always some risk, he has confidence in his projects because he is in control of the process. When I invest in real estate, I go through the same process. For example, when I buy a building, I am confident that I will receive the following four types of income:

1. Rental income
2. Depreciation income (aka phantom cash flow)
3. Amortization (my tenant pays off my loan)
4. Appreciation (the dollar is dropping in value)

I put appreciation last because it is the least important of all the incomes.

Yet, for most real estate investors, appreciation (capital gains) is the only income they are going after when they invest. For example, when someone buys a stock for $5 and holds it until it gets to $12 to sell it, he or she is selling for appreciation or capital gains. The same is true for people who flip real estate.

I put appreciation last also because it is taxed income, capital gains. The one blessing real estate has is the 1031 exchange, which lets the investor defer the tax on capital gains - sometimes forever, if you plan well.

To me, this ability to avoid capital gains makes real estate a far superior investment strategy for retirement and long-term wealth compared to paper assets such as stocks, bonds, mutual funds and especially savings.

Again, I stress that this example of real estate and paying less in taxes is completely predictable.

This *is* your retirement plan.

This is how your kids inherit and carry your wealth forward.

In 1996, the year I came out of retirement, I created my board game *CASHFLOW* and wrote *Rich Dad Poor Dad.* I had no idea how successful the Rich Dad Company would become. In the same year, I also started an oil company, a gold-mining company and a silver-mining company. While the oil company failed, the mining companies went on to become public companies via IPOs and a merger. The companies are listed on the Canadian Stock Exchanges and both companies have made me millions of dollars.

Many people said starting oil, gold and silver-mining companies was risky. While there *was* some risk, to me it was very little. I could mitigate the risk simply because I know we all use—consume—oil and gas.

I also knew that gold and silver would go up in value. How did I know? Because I knew the politicians running our country would not stop spending, would not stop borrowing, and would not stop printing money.

So, in this case, it was not gold and silver that were predictable. It was the financial incompetence of political leaders that was predictable. They do not solve problems. They simply push the problem forward and make the problem bigger.

What do gold and silver have in common with real estate?

They're all predictable.

Over to You:

At this point in the book, I think it's wise to pause. You've taken in so much it's time to see where you're at. You won't know how to reach your goal if you don't know where you're starting from.

So now, take a moment and assess where you are today.

Are You At Investor Level 1?

If there is nothing in your asset column with no income coming in from your investments and you have too many liabilities, then you are starting at the bottom level - ground zero. If you are deeply in bad debt, your best investment might be to get out of bad debt.

There is nothing wrong with being deeply in bad debt, unless you do nothing. After I lost my first business, I was nearly a million dollars in debt. It took me almost five years to reach zero. In many ways, learning from my mistakes and taking responsibility for my mistakes was the best education I could have asked for. If I had not learned from my mistakes, I would not be where I am today.

Kim and I put together a simple program and workbook explaining the process we used to get out of hundreds of thousands of dollars of bad debt. It is a simple, almost painless, process. All it takes is a little discipline and a willingness to learn.

The title of the product is "How We Got Out of Bad Debt."

You can purchase it online from RichDad.com

Are You At Investor Level 2?

If you are a saver, be very careful, especially if you are saving money in a bank or in a retirement plan.

In general, savers are losers. Saving is often a strategy for people who do not want to learn anything. You see, it takes no financial intelligence to save. You can train a monkey to save money. The risk in saving is that you learn little. And if your savings are wiped out, either by market decline or devaluation of the money supply, you wind up without money and without education.

Remember that the U.S. dollar has lost 95 percent of its value since 1971. It will not take long to lose the rest of its value. As stated, a person can even lose money saving gold if they buy gold at the wrong price.

I suggest taking a few courses on investing in real estate or get in touch with my team at Rich Dad to help steer you in the right direction.

Are You At Investor Level 3?

This level is similar to Level 2, except that this level invests in riskier instruments, such as stocks, bonds, mutual funds, insurance, and exchange-traded funds.

Again, the risk with this level is that, if everything is lost, the investor loses everything—and learns nothing. If you are ready to move out of Level 3, invest in your financial education and take control of your money, then Level 4 is a good level for you.

Are You At Investor Level 4?

If you are here as a professional investor, congratulations.

Very few people invest the time to learn and manage their own money. The key to success at Level 4 is lifelong learning, great teachers, great coaches, and like-minded friends. Level 4 investors take control of their lives, knowing that their mistakes are their opportunities to learn and to grow.

The fear of investing does not frighten them. It challenges them.

Are You At Investor Level 5?

To me, being a capitalist investor at level 5 is like being at the top of the world. The entire world is your oyster. The world has no borders.

In this world of high-speed technology, it is easier than ever to be a capitalist in a world of plenty.

If you are at this level, keep learning and keep giving. Remember that true capitalists are generous because a B-quadrant capitalist knows you must give more to receive more.

It's Your Choice

One great thing about real estate is that it gives you the freedom to choose to live the life you want to live.

In 1973 at the age of 26, I knew I did not want to live my life the way my parents chose to live. I did not want to be living below our means, living paycheck to paycheck, trying to make ends meet. For me, this was not living. It may have been good for them, but I knew in my heart that it was not right for me.

I also knew that going back to school for advanced degrees was not for me. I knew school did not make people rich because I grew up in a family of advanced degrees. Most of my uncles and aunts had masters' degrees and a few had their doctorates.

I did not want to climb a corporate ladder in the E quadrant either, nor did I want to be a very special specialist in the S quadrant. So I took the path less traveled and decided to become an entrepreneur and professional investor. I wanted the freedom to travel the world, do business, and invest.

It was my choice.

I do not recommend that path to everyone.

But I do recommend that a person choose. That is what freedom is: the power to choose. I encourage you to look at the five levels of investors and make your choice. Each level has its pros and cons, its advantages and disadvantages.

And each level has a price greater than money.

If you choose Level 1, 2, or 3, there are many other people and organizations qualified to support your investment life at those levels.

In 1997, Kim and I created The Rich Dad Company to provide educational games, programs, and coaches for those individuals who seek to be Level-4 and Level-5 investors.

The investors at these levels don't worry about money. Because they have assets that produce cash flow. They don't worry about retiring because their retirement is based on passive income from assets, not the stock market or a savings account.

And lastly, they don't worry about their children and loved ones. Because after they die, their loved ones will inherit their assets and continue to receive the cash flow those assets produce.

A Final Word On Investing

In the world of money, you'll often see the term ROI, Return On Investment.

Depending upon whom you talk to, ROI will vary. For example, if you talk to a banker, he or she may say, "We pay 3 percent interest on your money." For many people, this may sound good. If you talk to a financial planner, they may say, "You can expect a return on your investment of 10 percent per year." To many people, a 10 percent return is exciting.

To most people, especially those on the E and S side of the quadrant, the higher your return, the greater the risk. So the person accepting a 10 percent return already assumes there is more risk in that investment than the 3 percent return from the bank.

And there is.

Ironically, both the 3 percent return from the bank and the 10 percent return from the stock market are extremely high-risk. The money in the bank is at risk due to inflation and higher taxes caused by banks printing money. The 10 percent in the stock market is at risk due to volatility caused by HFT (high-frequency trading) and due to the novice investor investing without insurance.

In my world, ROI stands for a "Return On Information." This means that the more information I have, the higher my returns—and the lower my risk.

I caution you, because what I am about to say may sound insane or too good to be true. Yet I assure you, it is true.

In my world, the world of a Level-4 and Level-5 investor, an infinite return is expected—and with low risk. An infinite return as we've already covered earlier means: Money for nothing. In other words, the investor receives income without having any of their own money in the investment.

You know that I wrote that I took a real estate course in 1973.

And you already read about how after looking at over 100 investments, I purchased a condo on Maui using 100% financing, which means I used none of my own money. I put $25 each month into my pocket.

That $25 was an infinite return on my investment, since I had zero invested. I know $25 a month is not a lot of money. Yet, it was not the money that was important to me. It was learning a new way of thinking, a way of processing information and producing a result.

One of the reasons that I have so much money today is simply because I was educated and trained to think differently.

If you have read Rich Dad Poor Dad, you may recall that the title for chapter one of the book is, "The Rich Don't Work For Money." One of the reasons why those in the E and S quadrants have problems with that statement is because most went to school to learn to work for money.

They did not go to school to learn how to have other people's money work for them.

When Kim and I started The Rich Dad Company, we borrowed $250,000 from investors. We paid the money back once the company was up and running. Today, the business has returned multi-millions of dollars, not only to Kim and me, but to companies and individuals associated with Rich Dad.

As I always say, *capitalists are generous.*

My point is the moment a person knows how to make money out of nothing or with other people's money or a bank's money, they enter a different world. It's a world almost exactly opposite the world of those in the E and S quadrants where they experience hard work, high taxes, and low returns on investment.

The reason most people believe saving is smart and a 10% return in the stock market is worth it is simply due to a lack of financial education.

Your best ROI is not a return on your investment, but a return on your information. This is why a financial education is essential, especially for the uncertainty of the world ahead.

Remember this about the word "education": Education gives you the power to turn information into meaning. In the Information Age, we are drenched with financial information. Yet, without financial education, we cannot turn information into useful meaning for our lives.

In closing, I say the I quadrant is the most important quadrant for your future.

No matter what you do for a living, how well you do in the I quadrant will determine your future. In other words, even if you make very little money in the E or S quadrant, financial education in the I quadrant is your ticket to long-term freedom and financial security not just for you…

...but for everyone around you and for generations to come!

CHAPTER 15:

Sell Homes to Buy Apartments

As I mentioned in Chapter 1, in 1960, a tidal wave hit the town of Hilo, destroying acres of homes and businesses including Rich dad's first apartment complex in Hawaii.

The tidal wave was an event where the differences in philosophy between my rich dad and my poor dad became glaringly apparent.

My poor dad represented the city and state governments condemning the lands that lay in the path of tidal waves. Remember, it was not the first time a tsunami had hit the town of Hilo - it probably wouldn't be the last, either.

The problem was that some of the land he was condemning belonged to my rich dad.

My poor dad often called my rich dad a "slum lord" who exploited the poor. My rich dad saw himself as a "provider of low income housing."

My poor dad thought my rich dad should give the city and state his land for free. While I was doing my homework one night, I overheard my parents talking in the dining room. Poor dad said, "That man's a fool - those apartments are completely washed away. He thinks that piece of land is worth so much, but he probably can not ever build on it again. Why not just give it up and be done with it?" My mom murmured her agreement. I wondered to myself who was right in this matter.

My rich dad wanted a good price for his land. He thought of his land as an asset, and he would never waste an asset.

One day, while Mike and I were working in rich dad's office, we saw rich dad go into the meeting room with his accounting team. I asked Mike, "What's that about?" Mike shrugged. When the meeting ended, rich dad came out with a strange look on his face.

"Is everything ok?" I asked.

He looked at me and said, "Yes, it is fine. We were calculating the worth of the apartment land, and it is even greater than I thought. I worked many years to gain that asset - I will not be giving in."

The battle raged on. Trapped in the middle at 13 years of age, I began to understand the differences in philosophies between a Socialist and a Capitalist.

Do you know the difference between a Capitalist and a Socialist?

By definition, a Socialist is someone who values equality. They want things to be fair. They want equal opportunity. They want healthcare and education for everyone.

A Capitalist values inequality. They want higher pay, better education, a nicer house, bigger cars, and to live in better neighborhoods.

They do not want to keep up with the Jones, they want to beat the Jones.

In reality, most of us are both Capitalist and Socialists. We want the best for ourselves, yet we also want the best for everyone.

For a free society to survive, we need both Capitalist and Socialists. If either philosophy is too dominant, people suffer.

So, it is best to be both a little Capitalist and a little Socialist.

Something Bigger And Better

When rich dad realized he wasn't going to break the deadlock, he decided it was time for an end-run. Rather than fight the system, he'd beat it out right - by going around.

He sued the Hawaiian government and won. When the lawsuit was finished, he sold that previously to-be-condemned property to the government themselves and walked away with a large sum of money at his disposal.

Mike and I rode our bikes to rich dad's office one Saturday morning. Rich dad was in the office, seated at his desk with a stack of papers in front of him. He had a slight smile on his face as he flipped through the papers and motioned for us to approach.

Walking up to the desk, we saw that these weren't just any papers - they were real estate listings. Each one had a piece of land more beautiful than the last.

"Are you going to build more apartments?" I asked.

Rich dad shook his head and said, "I am planning something much bigger and better. Come with me, I will show you."

Mike and I piled into rich dad's truck. As we drove around town, we looked at each piece of property he was considering. He pointed out the good points and bad points of each one.

When we came to the final property on his list, he told us what he liked about it, and then asked, "What do you think I should do with this property?"

Mike and I looked at each other and shrugged. If not more apartments, then what?

With a note of quiet pride in his voice, rich dad announced, "You may not be able to see it yet, boys, but in this spot, you'll soon see a big, beautiful, and important hotel. I am fond of all of my assets, but this may be my best yet."

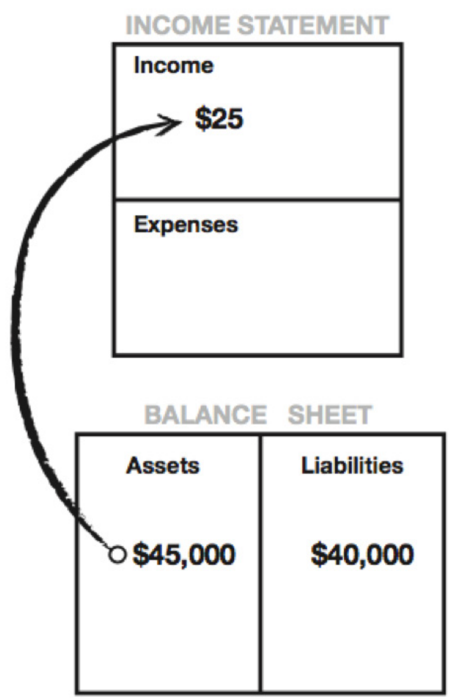
I'll never forget the day rich dad proudly showed me his big "red hotel," right smack in the middle of Waikiki Beach. He had completed his game of Monopoly®. It took him a little more than ten years, going from small green houses, to his big red hotel.

At the age of 21, I said to myself, "If rich dad can do it, so can I."

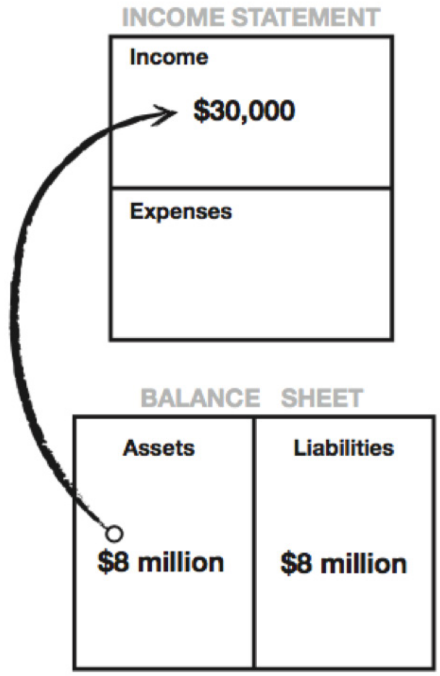
Money Loves Speed

There's nothing wrong with starting small. If it enables you to starts sooner rather than later, that's great - money loves speed, so it's good to start sooner rather than later.

For example, In 1989, Kim's first investment was a $45,000 two-bedroom, one-bath home in Portland, Oregon. Her financial statement looked like this:



After looking at thousands of deals and actually buying maybe 25 of them, she made the following investment in 2004: She purchased a commercial property for approximately $8 million and put down $1 million, which she borrowed, so it was 100 percent financed by debt. Her net cash flow looked like this:



In other words, every month she earns $30,000 net income. Also, this income, because it is passive income, is taxed at a lower tax rate than that of someone who earns wages of $30,000 a month. This is an exceptional investment. While such investments do exist, they are rare. But being financially literate, being able to have X-ray vision, has its rewards. If you do the math, the return on this investment is infinite. It sure beats the 10 percent returns the financial planners brag about.

Real estate investors and entrepreneurs derive higher returns on their money because creativity is allowed in real estate and in business. Creativity and controls are, for the most part, taboo in savings, stocks, bonds and mutual funds.

In 2005, Kim found another investment. This time she had to put down a million dollars of her own money, but this 2005 investment also pays her a net $30,000 a month. Today, her passive income, which is income without working, is well over a million dollars a year.

So yes, for many people starting small is fine. Maybe you're thinking this is the best choice for you, too.

Perhaps you're thinking about buying a $250,000 single-family home and making it a rental property. Or even a $320,000 duplex. But why rule out a $2 million, fifty-unit building?

Believe it or not, *any of these properties are within your reach.* Of course right now you're thinking, "No way! I can't afford a $2 million mortgage!" And to that I say, you may be right, but you don't have to be able to afford it. Here's why. Mortgages on smaller properties like single-family homes are almost always guaranteed through the buyer's own personal earning potential and wealth, but this is different.

You may be surprised to learn that larger investment property loans are secured by the asset itself. In other words, instead of the $2 million building riding on your own wealth, it is riding on its own valuation. This already is less risk to you.

Let's look at an example comparing and contrasting two of my own properties.

A single condominium I purchased for $116,000 with a $20,000 out-of-pocket down payment was 100 percent my responsibility - from mortgage to management.

The 182-unit, $9 million project that I owned 10% of (with no out-of-pocket cost) was actually less risky because I had no cash invested and the property was professionally managed.

The single condo property was mine, all mine—for better and for worse.

Five years later, I sold the condo for $121,000 - a gain of $5,000.

Recently, we refinanced the 182-unit building, which we had owned less than a year. Its newly appraised value was $11.3 million, more than $2 million above what we paid for it. And since I own 10 percent of the project, I made over $200,000 in less than a year.

This is a testament to the power of buying and managing right and managing well. This example also demonstrates risk related to valuation. When you buy a house or condo and rent it out, appreciation of the property rests solely on the appreciation of the surrounding neighborhood.

You better have bought in the right neighborhood, because there is little you can do to increase the value of your property.

By contrast, appreciation in commercial property, like apartment buildings, is based on the cash flow of the property itself. The more money it makes, the more money it is worth.

Now you're in control!

When cash flow increases, so does the value of the property. Manage your property right and you'll increase the value. Don't manage it right, and the value will stay the same or go down.

Another way larger properties are less risky relates to occupancy. When a single-family home is rented, it's 100 percent occupied. When it is empty, it is 100 percent vacant, and you are covering the mortgage out of your own pocket in its entirety. In a larger property, even an eight-unit building, if one resident leaves, you still have seven residents paying rent.

The more residents you have, the more your occupancy-related exposure is reduced.

That's why my rich dad always pushed me to trade in my single family homes for multi-unit apartments.

While you can start out with a $2 million property, the person or company you will be borrowing from is going to want to make sure you have experience before they will loan you the money. That does not mean you should quit.

In that case you have two obvious solutions:

1. Take on a partner with a lot of experience or,
2. Hire a property manager and get them to commit to managing the property for you.

Remember, the banks need to feel confident giving you a loan. Your job is to make it as easy and brainless for them as possible.

My First "Hotel"

After years of buying up single-family homes, I eventually made my move.

Following my rich dad's monopoly strategy to the letter, I sold all of them and used the money I made to buy my first apartment complex in Scottsdale, Arizona. Once I found a company to manage it for me (you should *always* do this) and took the necessary steps, I owned my first "red hotel."

One of the great things about multifamily investing is that you can factor property management into your calculations when buying an investment property. Find a deal that can provide income while supporting professional property management and your life will be easy.

To me, it's short-sighted to find only one building and make managing it your job. Instead, become an investor and find more great deals that you can purchase and have professionally managed. Spend your spare time educating yourself on the market, rounding up investors, finding better deals, and building the value of your portfolio so that you can leverage it into even more deals.

It's not like a single family home that can go from 100% to 0% occupancy in 1 day. This complex is a "red hotel" that pays me monthly, even if several families move out at once. This is why real estate is one of the ultimate investments - real estate gives you the ability to leverage, receive cash in your pocket each month, and realize tax benefits all at once.

This gives you a purpose in retirement and helps you build long-term wealth. As you read previously, generational wealth isn't just about acquiring money. It's about acquiring assets that make money. Here I am today in 2018 and I still own this very same complex.

No matter what happens in the market or the economy, people will always need to live somewhere. This is why a multi-family complex will weather any economic storm. Likewise, if you get to the status where you own several multifamily units (like we do), your retirement and ability to pass on wealth will multiply over and over again.

Dream Big, Then Take Big Action

If you're at the beginning of your real estate investment journey, you may be thinking this is all impossible - or at the very least, an incredible far-off goal.

That couldn't be further from the truth. If you have the guts to jump in - even if you start small - you, too, could be just a few years from your "big red hotel". Here's how it worked for one investor we know...

Real life example -

Blake was an auto mechanic who knew that the way to wealth was through real estate investing. As an auto mechanic, he could only get paid when he repaired a Range Rover or tuned a T-bird. If he wasn't working, he wasn't getting paid.

But by owning real estate, by collecting rents from tenants, he got paid whether he showed up to work or not. And knowing this, Blake set out to acquire real estate according to the most tax-efficient means possible. Blake had acquired two properties in the last four years. One was a two-story, tan-colored 4 plex in a strong rental neighborhood. Blake had used deferred maintenance issues (the need for a new roof and air-conditioning units) to obtain a below-market price for the property. The 4plex, even after the improvements were made, provided Blake with positive cash flow each month.

His second property was a duplex in a transitional neighborhood. Blake had hoped that the area would improve at a faster rate and that the tenant mix would improve as well. But this was not happening quickly enough for Blake.

So Blake decided to sell the duplex and acquire another property in an area with greater appreciation potential. He was concerned about having to pay taxes on the tidy gain from the sale of the duplex, so he met with his CPA to better understand his tax situation.

The CPA was glad Blake had come to see him. By doing so, he was able to let Blake in on an incredible tax strategy that would save him $10,000.

Blake was intrigued and asked for more information.

The CPA explained that by selling his old property using a "1031 exchange," Blake could defer taxes if he reinvested all the proceeds from the old property into a new property. Blake liked the sound of this strategy and, following his CPA's advice, engaged in the following:

First, Blake sold the duplex for $100,000. With just $7,500 down, he had only paid $50,000 for it four years ago. So with the sale, he had a nice profit of $50,000 on it. Because he had held it for over one year, the capital gains tax (at this writing) was 20 percent (or $10,000 on a $50,000 gain) plus any depreciation recapture. That is, if he had sold the property (instead of exchanging it as he is doing in this example) he would have to pay a higher tax on the amount he had previously depreciated. (Again, because of the exchange, the capital gains and depreciation recapture are deferred.) Blake's property and residence were in a state that didn't have a state capital gains tax, so all he had to deal with was the federal capital gains tax. The CPA noted that if Blake moved to, or held property in, a state with a capital gains tax, he would have to factor that state tax in as well. But, again, the point of the transaction was to defer capital gains taxes and depreciation recapture until a later day.

The CPA instructed Blake to line up a "qualified intermediary" to handle the monies received from the escrow closing. Blake couldn't touch the money or the 1031 transaction would fail. The money had to go straight to a qualified intermediary.

The CPA then indicated that Blake had 45 days to identify a new property and 180 days to close on it. So Blake set about promptly locating a new property. After two weeks of searching, he found a 5 plex in an appreciating area for $300,000. With the $50,000 held by the qualified intermediary and new financing of $250,000, Blake purchased the 5 plex. The $10,000 in capital gains (again, plus depreciation recapture) he would have had to pay the IRS in a traditional sale situation was deferred and could be used tax-free to buy a bigger property.

Blake liked this real estate strategy. He learned that he could continue to trade up to bigger properties as long as each one was held for a year and a day.

Over the next five years, Blake traded up three more times. At the end of this run, he owned an immaculate 24-unit apartment building as well as the original two-story, tan-colored 4 plex. Both properties had positive cash flow, giving Blake hope that someday soon he could retire from the auto mechanic business with a nice, continuing income stream. And Blake had to pinch himself when he thought about the benefits of 1031 transactions. After all, he had started out buying a duplex with just $7,500 down, and without putting in any more money along the way, or paying taxes on any gains, he now owned a cash-flowing, 24-unit apartment building for essentially $7,500.
What a great country!

Don't Wait. Start Now.

While I think it's smart for those nearing retirement to consider putting their funds into multi-family, it would be even smarter for young people to begin investing the same way.

As the old saying goes, "Youth is wasted on the young." Don't let your youth be wasted. Rather, begin planning for your future by investing in your financial education and building a portfolio of assets that will provide for you and your family when you're ready to retire.

Kim began investing in her twenties with one two-bedroom house in Portland, OR. Today, she owns thousands of units in multiple states that bring millions of dollars into her pocket each year.

Anyone can do this. Don't wait until someday. Start now.

CHAPTER 16:

Infinite Returns

Case Study- How the Rich Dad Team Earned an Infinite Return on the Edgewood Apartment Complex in Tucson, Arizona

Back in 2004, myself, Kim, and Rich Dad Advisor Ken McElroy put together a deal that gave all of us an infinite return.

We became aware of a deal in our local area that was too good to pass up.

The 144 unit Edgewood Apartment complex was up for sale. Now, this by itself is a great buy since multi-family apartment complexes are always a great investment on their own. This lines up with the 4 green houses, 1 red hotel idea.

You see, the mistake a lot of people make when they decide to get into real estate is going all in on one single-family residential home and expecting it to produce a substantial cash flow. But this isn't the case with one home. When that single family moves out, you have a 100% vacancy rate and the house payment is now on you.

Not so with multiple single-family homes or a multi-unit apartment complex.

When you own 4-10 homes and a single family moves out, you can sustain the vacancy for a while because your other properties are still creating cash flow. Same goes for an apartment or condo unit.

It's simple math. With 100+ units, you can have 10 families move out at the same time but still maintain a 90% + occupancy rate.

And this is why I always steer new real estate investors to multi-unit complexes, or, multiple single-family units.

The Deal

What made the Edgewood deal so appealing wasn't just the fact that the complex had 144 units. It was the little bonus that only the trained eye could see right away - *the 10-acre empty lot for sale that was right next to the complex!*

We did some homework and figured that this extra 10-acres of land could be turned into an extra 100 apartment units and then attached to Edgewood.

This would mean a 69% increase in available units (and when fully occupied, a big payday for all of us).

So, we got to work on the deal:

- Edgewood was listed at $7.1 million
- The 10-acre lot next door was up for only $500,000

Now, smart real estate investors acquire debt. And I'm not talking about credit cards and car payments, I'm talking about *good debt.*

"Whoa, whoa, whoa", you might be thinking, "Isn't all debt bad? Shouldn't we do everything in our power to avoid debt?"

The answer is YES - you should avoid bad debt, and NO - once you have the right financial education, you can actually USE good debt to propel yourself forward far faster than if you'd scrimped and saved and only used what personal funds you had available.

Here's the difference.

Bad debt is debt that takes money out of your pocket, such as credit card debt, car loans, and more. Bad debt is a sign of deeper problems. People with too many financial worries from bad debt may feel like it's eating them alive on the inside.

Good debt, on the other hand, is debt on which you receive money in return. Good debt makes you richer, such as a loan for investment property or to purchase equipment for your business that will make you a return. This is the type of debt that is used to buy assets.

As rich dad said, "You should treat all debt, good or bad, the same way you treat a loaded gun—with a lot of respect. People who do not respect the power of debt are often financially wounded by it—sometimes killed. People who respect and harness the power of debt may become rich beyond their wildest dreams. Debt has the power to make you very rich, and it also has the power to make you very poor."

All that being said, this is not about accruing bad debt and creating a hole you can never dig yourself out of.

This is about leverage and using other people's money (OPM) to put deals together. Why would you dump millions of dollars of your own money into something if you don't have to?

The money you do have can be used for other deals. Even if you don't have millions at this point (or even thousands), think about it this way - w*hy dump any of your money into something if someone else is willing to do it for you?*

You should always be looking to leverage OPM in every real estate deal you're involved in.

Using OPM - Other People's Money

To make this deal a reality, we went to the bank.

As you may have guessed - banks love me. They absolutely love lending to me because I make them money on every deal. So after a visit with my banker, we were able to get a loan on the Edgewood deal for $4.9 million.

 $7.1M
-$4.9M
=$2.7M

After the bank gave us the green light on the $4.9M, we went from needing $7.1M to only needed in $2.7M to close this deal. So did I fork over $2.7M of my own money for this? No way. Kim and I put up $1M of our own money, Ken added to the pot, and some private investors went in on the rest.

And this is how we came up with $7.1M in just a few weeks and purchased Edgewood and the 10-acre lot at the same time.

But there was still a piece missing - we needed funds to build the additional units on the 10-acres next door.

Once again, rather than paying for this out of our own funds, we found a way to get someone else to pay for it - the bank.

After meeting with our contractors, we got a bid of $5M to build the additional units. Again, we went to the bank, leveraged their money, and walked away with a $5M construction loan which translated into an additional 108 units for Edgewood.

Now we were sitting at 252 units.

After taking one year to build and one year to get Edgewood fully leased out, we went back to the bank for a better deal.

Pay close attention. This is where it all comes together.

The magic happens when a better deal is made with the lenders.

At this point, the numbers looked like this:

- Original bank loan - $4.9M
- Investors owed - $2.7M
- Construction loan - $5M
- *Total borrowed: $12.1M*

Total still owed:

- Original bank loan + construction loan - $9.2M
- Investors owed - $2.7M
- *Total owed: $11.9M*

Now here's where things get lucrative.

After all the units were occupied and built out, the new appraisal on the property came in at $15.7M! This was a substantial increase in equity that would allow us to take out a new loan, pay everyone back with interest (including ourselves), and achieve an ***infinite return.***

So we took out a brand new refinanced loan from the bank and here's how we used those funds to turn a great deal into a spectacular one:

- PAID IN FULL - original bank loan + construction loan - $9.2M
- PAID IN FULL - investors - $2.7M
- PAID INTEREST TO INVESTORS -$600k
- **Total to pay off the entire deal:** $12.5M

Now everyone was happy.

The bank was paid in full, the investors were paid in full plus interest (Kim and I got out $1M back plus an additional $200k, while the other investors received their money back plus an additional $400k).

Everyone made money on the deal including myself, and we only had one loan with the bank at $12.5M for a 252 unit property with the Edgewood Apartments were bringing in $300k a year in profit **after the bills and bank loan were paid.**

This is what I call an *infinite return.*

We now own a property that makes us $300k every year on its own. We wake up to the money. It's passive. Sure, we had to do the work to make it happen but after the deal was done and paid off, it became infinitely profitable for us.

But Robert, What About the Taxes?

Kim and I put $1 million into Edgewood and got $1.2 million back. That's $200,000 - an impressive return that far exceeds what you can typically achieve with even the best stocks and bonds.

Not only this, we get paid every month on Edgewood and do almost nothing to keep this cash flowing every month. This provides us with an infinite return. This is far more lucrative than a 9% ROI from investing in a mutual fund.

But what about the taxes?

This is a question I get almost every time I tell one of these stories. And it's a valid question because if you don't know how to leverage the government tax loopholes, you'll end up getting screwed.

And this is why you must have a competent accountant as part of your team (I'll get into building your team later on in the book). So, assuming you have an accountant on your team who knows how to squeeze every last penny out of the government when it comes to taxes, not only will you pay no taxes on a deal like this, the government will actually ***pay you*** for putting it together!

How is that even possible?

Here's how this deal went for me:

I put in $1M and got $1.2M back. That's a nice chunk of change (a 20% ROI)! And in addition to getting my initial investment back and profiting $200k, I'm also getting monthly checks from the Edgewood tenants that are bringing in $300k a year.

"But Robert, do you have to pay taxes on the $1.2M?!"

No. The $1.2M is totally tax-free because debt isn't taxable. And because of the way the US tax system is set up, I'm not paying taxes on the $300k I'm bringing in either.

There are so many tax benefits in real estate deals, I got to offset some of the other income and the government actually wrote me a check!

Why? Because the government wants us to do this.

By building additional residential units, we provide housing and jobs while using debt. The government likes all of those things. They want us to use debt. They want us to provide shelter. They want us to help boost the economy with new jobs. And as a reward, they incentivize us. And that's all the tax law is - a series of incentives to get private businessmen like me to do their work for them.

So now you have a general idea of how to put together a win-win deal for everyone involved, see an infinite return, and pay little to no taxes on the back end.

This is the Rich Dad way.

And it could be true of your life as well if you take the time to learn it.

Take a moment and imagine what your life could look like if you put not only one of these deals together, *but multiple ones.* And you don't have to start this big in the beginning either. You can start small and work your way up to it. Then once you get your first big deal and have a steady stream of cash flow coming in, do it again, and again, and again.

Could you imagine how your life will change when you have two, three, or four + "Edgewood deals?" on the books?

What will that look like? Seriously, take 30 seconds and think about it.

My guess is that life looks drastically different than it does today.

A Tale Of Two Properties

When you're ready to put deals into play, one important thing to remember is the importance of finding a property manager. Many people figure, "Oh, I only have a few places - I can handle things on my own in my spare time," but what they fail to factor in is just how complicated things can get.

When you're imagining the life of your dreams, chances are good you're not imagining being woken at 3AM to change a tenant's light bulb, or having your car windows smashed because a tenant is unhappy about a rent increase. That's where a property manager comes in - they handle all of this and more.

A great property manager is the key to success in real estate investing. The reason for this is that great property managers create value. Value, when it comes to investment real estate, is not only a function of markets, but it also impacts your bottom line. Your real estate is only as valuable as your renters think it is—what they are willing to pay in rent. Rental income is ultimately the aspect of real estate you have the most control over. (And thus it's the aspect that presents the greatest opportunity for failure as well.)

Property managers are valuable members of your team because they specialize in your real estate market, and they know how to maximize your investment's income-producing potential.

Property A - Real Life Example

Not too long ago, I heard the story of a couple who had bought a house in Washington state as a rental property. The house was at the end of a cul-de-sac in a nice neighborhood consisting of mainly home owners. It was a good size with four bedrooms and three bathrooms, so they usually rented it to families. They bought the house years ago for about $70,000, and today it is worth about $350,000. In that respect, they have done very well with the house as an investment. They even had pretty good luck with renters for the first ten years or so, with only minor damage to repair here or there, and not too many challenges in collecting the rent. But all that came to an end when they met the "problem renter."

Now, don't misunderstand me. I don't tell this story to mock this couple or their decisions. Rather, these people are intelligent people who faced an overwhelmingly difficult situation regarding their rental property—a situation that was unfortunately nobody's fault but their own.

These folks found a problem renter, we will call him Ross, through an ad they placed in the paper. They went through the usual process they used when assessing a potential renter. They performed some reference checks and had a personal meeting with him. Right up front he said that he'd just filed for bankruptcy, but because these folks are very nice people they still felt compelled to rent to him. Heck, Ross's pastor even cosigned for him, so it didn't seem like a big risk. This renter had quite the story - his brother was in jail, and he and his wife were taking care of the brother's two children, and they were all living in an apartment with two small children of their own at the time. The sob story was they needed more space.

This is where better judgment left the property owners' minds. Their hearts took over and they rented to them... Without the due diligence of checking into this renter any further.

Immediately Ross's deposit check bounced. He had a story for that too. (They always do, by the way.)

Still, the couple continued to cut him slack. They summed it up this way: "He always had some story for it, which even I believed initially. You know you don't want to kick somebody out right away. We didn't really have a big problem with the rent initially back then. I laugh about it now, because the biggest problem was that we didn't get the rent on time. Compared to what we went through later, it was not that bad. And when we would go down there to visit, the house was always clean, always looked good. Initially."

By now you are probably sensing that as the situation developed, late rent was the least of their concerns—and you're right. Eventually, Ross started not only paying late, but not paying at all—$15,000 in back rent when all was said and done, over nineteen months' worth of rent. On top of all that, Ross was a self-proclaimed handyman, who had worked as a carpenter and as a landscaper. Without the permission of the property owners, he began to initiate projects around the house that he deemed to be improvements. Not necessarily a bad thing - except that he never finished any of them.

Over the course of time that he was in the house, Ross had started the following projects:

- Completely tore out the front and back yards, including retaining rockeries on both sides of the backyard, causing damage to the neighbor's yard. He also accidentally knocked the deck of the back of the house.
- Removed every interior door in the house.
- Removed every baseboard in the house.
- Removed all kitchen cabinets and all kitchen appliances.
- Tore out all bathroom vanities.
- Started to install a Jacuzzi.
- Expanded a closet into the garage, making it impossible to park a car in the garage.
- Demolished a wall in the downstairs utility room because he wanted a bigger bathroom.
- Removed all carpet n the upstairs in order to lay down hardwood flooring.
- Started rounding corners on all walls.
- Started installing an oversized shower in the downstairs bathroom.

None of these projects was overseen by a licensed contractor. Consequently, there was a host of plumbing and electrical issues to be dealt with, as well.

Beyond all of these issues, Ross had also stolen money from the property owners.

"This happened the summer that we finally got him out of there," the property owner explained. I finally said, "We need to go find out where the rest of these landscape blocks are that had been in the backyard,' and so we went up to the business where we paid for the blocks. And after some head scratching and 'No, I don't remember,' the block company finally found that Ross had actually come in the summer before and returned the blocks for a refund of over $600."

You might be asking yourself, "How could they let this happen?"

These folks are by no means novice investors. They own four properties in the Seattle area, and until the problem renter, they managed the properties themselves while living in Scottsdale, Arizona, part of the year. They make a point of saying that until the problem renter they never really had any issues, but that is more from the luck of the draw than from calculated strategy. In fact, it was their lack of sound property management fundamentals that landed them in this very grave situation.

They suffered from "hold on and hope it gets better" disease, which makes you believe that someone will change their behavior this time regardless of an established pattern of past behavior. It almost inevitably starts out sounding a little something like this: "But, when somebody has been renting for years and paid you over $100,000 in rent, you cut him a little bit of slack, knowing that he was capable of doing good work if he would just focus on it. We tried our darndest to try to get him to focus on some of these projects to try and get them done."

And it always ends sounding like this: "But that turns out it was too much to hope for. It became very obvious in the last year and a half that things were not going to get done. The only way they were going to get done was for us to get him out of there and finish them ourselves, along with the help that we hired. Once we came to that conclusion, then the effort was directed at getting him out of the house."

Mr. and Mrs. Property Owner ended up hiring a property manager who was responsible for evicting Ross from the house. The damage, however, was already done. And in the fall of 2004, they came out of retirement and traveled to Seattle from Scottsdale to begin repairs on the house.

They had to enlist the help of two friends as well as a contractor. It took five people in all to do the work needed. Those five people worked every day for six to eight hours from September until November in order to get the house livable again. Three months of their retirement were gone.

All said and done, the costs associated with their decision to rent to Ross were:

Back Rent $15,000

Repairs $55,000

Not raising rent in nine years $40,000

Total $110,000

Pretty unbelievable, huh? The most amazing part is that they had only paid $70,000 for the house when they bought it. Expenses stemming directly from poor property management had cost him over 1.5 times the original cost of the house. Ouch.

Property B - Real Life Example

In contrast to that, consider the following: Ken McElroy owns a property in Oklahoma. It's true that his Arizona company specializes in property management, managing over 8,000 units.

Do you think he uses his company to manage his out of state properties? Not on your life. They are based in Scottsdale, Arizona. The time and effort required to set up successful operations in Oklahoma would be a huge waste of energy and money.

Here's what Ken did instead. He developed a team. In real estate there is nothing more important than building a team. Through the entire process of acquiring and managing his Oklahoma City building, he used the efforts of his team to achieve maximum success.

From enlisting a local broker to find the property and provide detailed market data, to an attorney to draft and review legal documents, to the due diligence advisors from my company to explore every square inch of the property before we bought it, his team was involved.

If you think you can do real estate by yourself, you are sorely mistaken. Experts will always see details in a minute that you or I would totally miss. In the case of the Oklahoma property, Ken decided to hire a property management company to manage the property for him.

While he did his homework in purchasing it and had a pretty good idea of the market at the time, that data might be no good in a couple of months. Markets are constantly changing.

Not only is the market of Oklahoma City constantly changing, but the property's location is a submarket within the market, and that submarket is constantly changing. In the southern part of the city there might be concessions because of low occupancy, but in the north, occupancy might be high and there would be no specials. Could you imagine if he just

Googled "rentals in Oklahoma City" from his office in Arizona and saw that there were specials in the market and decided to apply them to my property in the north submarket where there were no specials? If you do that, you might as well just stand out on the street and hand out money.

When you live 2,000 miles away it is impossible to keep up on all the minute and shifting details in a market. That's a headache I don't want. Neither did Ken, and neither do you.

The last thing Ken wanted was to miss opportunities for profit on his Oklahoma City property. That is why he hired a local expert on the apartment market. There is no way he could manage it effectively from his office in Scottsdale. Because he had the foresight to do so, his property is profitable, and he earns regular cash flow with minimal effort.

Nuts And Bolts

Property management is a down-and-dirty business.

It's true. Real estate investments are not neat and clean like stocks or bonds. They are not paper that just gets moved from one account to another. They require you or someone you hire to roll up your sleeves and get your hands dirty.

Your success depends on the area. You want to know what your competition is and why they are doing well. If you see that your comps are newer then you might be able to renovate and have a value add that can compare to the newer community.

Sometimes you might realize that the reason it's not making money is because of the delinquency, in this case you need to look at two things:

- Is it that you have lazy management that doesn't make collecting a priority? (or)
- Do you have residents that are not qualified to live there (this may be a management issue as well)? In that case, you need to rid the property of the manager or the residents and start over.

A few of Ken McElroy's properties are in less desirable areas which could hurt their marketability. So, they hired courtesy patrol and added that to the marketing of the properties so people knew that we took their safety seriously.

Sometimes it's as simple as a value ad like a dog park or a washer and dryer. For instance, Ken doesn't have breed restrictions or charge pet rent on his units. As a result, in some areas the humane society adds us to their website and suggests our units because we are more lenient on large breeds.

All this is to say that when you have the right deal *and* the right team in place, you too can earn infinite returns.

CHAPTER 17:

Next Steps & Building Your Team

Intelligent people are those who work with or hire a person who is more intelligent than they are. When you need advice, make sure you choose your advisors wisely.

If you are serious about becoming rich through real estate, you must do the following things over and over again, from now until forever, for the rest of your life.

The problem is, only a few people will do them... and do them... and do them.

Grow Up

The other day, a friend of mine was complaining that he had lost several million dollars in the stock market. He was new at investing, had borrowed money to buy stocks, and now had lost almost everything, including his house, after the market crashed. He kept complaining loudly, and I finally had enough.

I said, “Grow up. You’re a big boy now. What made you think the stock market would always go up?”

My comment did not stop him.

He kept on saying, “Why didn’t the Fed lower interest rates earlier? Why did they have to raise them? It’s their fault and my stockbroker’s fault I’ve lost everything. How will I pay back all that money? Why doesn’t the federal government do something about the losses on the stock market?”

As I walked away, I repeated what I said earlier: “Grow up.”

Rich dad often said, “People get older, but they do not necessarily grow up. Many people run from mom and dad’s shelter to the shelter of a company or the government. Many expect someone else to take care of them, or be responsible for their lack of wisdom and common sense. That is why they seek job security or government sanctuaries. Too many people spend their lives looking for guarantees and spend all their lives avoiding risk, avoiding growing up, and always looking for a surrogate parent to take care of them.”

I know many people who are not able to survive without Social Security. I know people who are not yet old enough to collect Social Security, yet they are counting on Social Security and Medicare to be there for them in the future. Those government safety nets were created in the Industrial Age and were created only as safety nets for the very needy. Today, unfortunately, many people, even highly educated and highly paid people, are still counting on the government to take care of them.

We are in the Information Age, and it is time we begin to grow up and mature financially. Leave the government safety nets and social programs for those who really need them.

When I left high school, I thought I was grown up and knew all the answers.

Today, I often say, "I wish I knew back then what I know today."

There are many things I did in my past that I am glad I did, but I would not do them today. Growing up means doing things differently as we grow older. To continually do the same old thing every day of your life is, in many ways, arrested mental and emotional development. The world is changing, growing more sophisticated, and so should we.

One of the ways the world is changing is that there is not much job security and financial security anymore.

Companies are pushing people out into the cold, cruel world and saying to them, "Don't expect us to take care of you once you stop working for us."

They are also saying, "You'd better count on the stock market to take care of you once you stop working." Yet in the cold, harsh, real world, to expect the stock market to always go up is childish fantasy and as silly as expecting the tooth fairy to pay for your dental bill.

Growing up means being willing to be more and more responsible for yourself, your actions, your continuing education, and your maturity. If you want to have a rich and secure financial future, it is imperative to know that markets go up and markets come down and no one is there to protect you. The faster we grow up and face reality, the better we can then face the future with greater maturity. In the Information Age, more of us need to grow up and grow away from old Industrial Age ideas of expecting someone else to be responsible for our job security and financial security.

It will soon be obvious that the Industrial Age is dead and gone. We will know this when the government finally admits that it is broke and will not be able to keep many of its financial promises. If too many people panic and begin draining their 401(k)s, the stock market will crash, many people will be disappointed, and America may go into a deep recession, possibly a depression. If this happens, millions upon millions of baby boomers and their children will finally have to grow up. Growing up means that you become less and less dependent upon others, and are more and more able to take care of yourself, your needs, and the needs of others.

To me, growing up is a lifelong process, a process that many people are avoiding by still seeking job security and financial security provided by someone else, someone other than themselves. Continually growing up is an important habit. If you are to retire young and retire rich, you will need to grow up much faster than most people are willing to.

Be Willing to Fail More

One of the biggest differences between my rich dad and my poor dad was that my poor dad was unwilling to fail. He thought making mistakes was a sign of failure. After all, he was a teacher. My poor dad also thought that in life there was only one right answer.

My rich dad constantly ventured into areas that he knew nothing about. Rich dad believed in dreaming big, trying new things, and making small mistakes.

He said to me at the end of his life, "Your dad spent his life pretending he knew all the right answers and avoiding mistakes. That is why that the end of his life, he began to make big mistakes."

Rich dad also said, "One of the great things about being willing to try new things and make mistakes is that making mistakes keeps you humble. People who are humble learn more than people who are arrogant."

Over the years, I watched rich dad go into businesses, ventures, and projects he often knew nothing about. He would sit, listen, and ask questions for hours, days, and months as he gained the knowledge he required. He was always willing to be humble and ask stupid questions. He would say, "What is stupid is to pretend you are smart. When you pretend to be smart, you are at the height of stupidity."

Rich dad was also willing to be wrong. If he made a mistake, he was always ready to apologize. He did not try to be right all the time. He would say, "In school, there is only one right answer. In real life, there is more than one right answer. If someone has a better right answer than you, take it. Then you have two right answers."

He would also say, "People who have only one right answer are very often three things. One, they are usually argumentative or defensive. Two, they are often very boring people. And three, they often become obsolete because they fail to notice that their once-right answer is now wrong."

So rich dad's advice was, "Live a little. Do something daring and a little risky every day. Then, even if you do not become rich, this habit will keep your life exciting and keep you younger for years longer."

Unfortunately, my poor dad spent his life doing all the "right things". He did the right thing when he went to school. He got a job teaching because, in his mind, it was the right thing to do. He worked hard and climbed the ladder because it was the right thing to do. He ran against his boss because he was upset with the corruption in government because it was the right thing to do. At the end of his life, he spent 20 years in front of the TV set, angry because he had done all the right things and no one seemed to care. He got very angry when he thought about all of his peers who he thought did the wrong things, but now were rich or in positions of power.

Rich dad said, "Sometimes what is right for you at the beginning of your life is not the right thing for you at the end of your life. Too many people are unsuccessful simply because they are afraid of changing or are unable to change with the times. The reason they are unable to change is because they are afraid of being wrong. Sometimes to be right, we all need to be wrong. If we want to learn to ride a bicycle, we must go through being wrong for a while. Most people are unsuccessful simply because they want to be right, but they are unwilling to be wrong. It is their fear of failing that causes them to fail. It is their need to be perfect that causes them to be imperfect. It is their fear of looking bad that causes them to ultimately feel badly about themselves."

Rich dad's secret was that the world is designed for us not to fail. The world is designed for us to win. The challenge is to be willing to first fail so you can win. Once you understand this secret, you will be more willing to fail in order to win. As rich dad often said, "People who avoid failing also avoid success. Failing is an integral part of success."

In summary, my rich dad was willing to fail a little each day. My poor dad did his best not to fail at all. The difference in these little habits made a big difference toward the end of their lives.

Listen To Yourself

The last and most important habit for anyone who wants to retire young and retire rich is to listen to yourself.

Rich dad often said, "The most powerful force I have is what I say to myself and what I believe." This habit is another way of expressing your reality or your context. What rich dad meant by "most powerful force" goes back to the Biblical concept that your words become flesh. In other words, pay close attention to what you are saying to yourself, because what you are saying to yourself is what you are becoming each and every day.

Rich dad told me, "Losers focus a lot on what they don't want in life, rather than be specific with what they do want. That is what they do differently. It's a habit. The same is true with money."

"So there is a big difference between someone who constantly says, 'I don't want to be poor,' and someone who says, 'I want to be rich,'" I replied.

Rich dad nodded and said, "It seems to me that the human mind does not hear do or don't. It just hears the subject being discussed — words such as fat, healthy, poor, and rich. Whatever the subject is, is what you become."

"So when someone says, 'I don't want to lose money,' all the mind hears is, 'I want to lose money'?" I asked, seeking further clarity from rich dad's lesson.

"That is how it seems to me," said rich dad.

"So what many people do is talk about what they don't want, or talk about what they can't have," I said.

"That is correct. But I do something more than that. It is one of my habits," said rich dad.

"Something more than just say what you want?" I asked.

Rich dad nodded and gave me one of the most important habits for my life. He said, "We all feel frightened, uncertain, and doubtful at times. That is part of being human. When I feel that way, the first thing I do is check my thoughts. If I feel bad or afraid, I know I am saying or thinking something to cause myself to feel that way."

"Okay," I said. "What is the next step?"

"I change my thoughts or words to words I want," said rich dad. "For example, if I am afraid of losing, I say to myself, 'What am I afraid of, what do I want instead, and what do I need to do to get what I want?' If you notice, they are all questions that first open up my reality to new possibilities and realities."

I nodded and said, "Then what?"

"Then I sit quietly until the feeling of fear leaves and the feeling I want comes into my heart, chest, and stomach area. Once I can feel the feeling I want, and I have the thoughts I want, I then take action. I prepare myself first, I get into the right frame of mind, the emotional feeling I want rather than what I don't want, then I take action."

The summary of this process is:

- Notice the thoughts you don't want. Change to the thoughts about things you do want.
- Notice the feelings you don't want. Change to the feelings you do want.
- Take action, and keep going, correcting if necessary, until you get what you want—rather than what you don't want.

Assembling The Team

It's easier to borrow a million dollars than to save a million dollars.

There is one catch. Before your banker will lend you the million dollars, your banker will want to know that you are trustworthy with the money. One of the ways the banker will feel comfortable lending you that much money is if you have clean, professional financial records in the form of a financial statement.

Most people cannot qualify for large loans because they have poor records. Many people pay higher than necessary interest rates simply because they have poor financial records. In Rich Dad Poor Dad, I wrote about the importance of financial literacy. The basis of financial literacy is a financial statement. That is what your banker will want to see if he or she is to lend you substantial amounts of money.

Even if you do not have a business, your personal life is a business, and all real businesses have bookkeepers. That is why I strongly recommend you hire a bookkeeper and keep a bookkeeper for life. By having a bookkeeper keep your income, expenses, assets, and liabilities in line, you begin to keep professional records. I also strongly recommend you sit down with your bookkeeper and go over your numbers each and every month. Repetition is how we learn, and by repeatedly going over your monthly numbers, not only do you establish a good habit, you gain more insights into your spending patterns, you can make corrections earlier, and you ultimately take control over your financial life.

Why not do it yourself? Why hire an outsider?

Here are just some of the reasons:

- You want to start being a B- or I-quadrant person. All professional B's and I's have professional bookkeepers. So treat your personal financial life as a business now. As described in Rich Dad Poor Dad, one of rich dad's six lessons was: Mind your own business. That begins with hiring a professional bookkeeper.

- You want a disinterested outside third party to look objectively at your money and your spending habits. As you know, money can be an emotional subject, especially if it is yours. By having a person who is not emotionally attached to your finances, he or she can put things in order and speak to you clearly and logically. I remember my mom and dad did not discuss money. They argued and cried about money. That is hardly objective money management or discussion.

- My poor dad did not want to look at his financial situation. He kept our financial troubles a personal secret—a secret from himself, his family, and from anyone else. We kids knew our family was in financial trouble, but we did not discuss it. We kept our financial problems a secret. Psychologists will tell you that family secrets become toxic. In other words, secrets poison the family. I know the emotional pain from our financial struggles did indeed affect all of us, even though we kept it a secret.

- By hiring an emotionally unattached professional bookkeeper, you can bring your financial challenges out into the light where you can deal with them. By being able to discuss your financial statements with your professional bookkeeper, you bring the subject of money and the business of your life out into the open. If it is out in the open and you are discussing your finances with a professional, you are more able to make the changes or tough decisions you need to make, before the financial problems become toxic.

- If you earn less than $50,000 and are in the E quadrant, a professional bookkeeper should not cost more than $100 to $200 a month. I hear people say they would rather spend that money on food or clothing. The problem with that thinking is spending your money on food or clothing will not solve your money problems and will not make you richer.

As rich dad always said, "There is good debt and bad debt, good income and bad income, good expenses and bad expenses."

He told me hiring a bookkeeper and other professional financial advisors was money that went for good expenses, simply because these were expenses that made you richer, your life easier, and prepared you for a better future.

- If you truly cannot afford a bookkeeper, then find one who will trade services. You can clean their house or their yard and, in exchange, they can do your books. The most important thing is to do it, regardless of the price, because the long-term price is too high. As rich dad said, "Your greatest expense in life is the money you do not make."

- Most importantly, hiring a professional bookkeeper reminds yourself that you are taking your personal financial life seriously. It means at least once a month, you sit down with your bookkeeper, you are held accountable, and you learn, correct, and redirect the financial future of your life.

Your banker will NEVER ask you for your report card. What your banker asks for is your financial statement. Rich dad said, "Your financial statement is your report card once you leave school." In school, we received report cards at least once a quarter. Then, even if you had bad grades, the report card gave you and your parents the opportunity to know what you were good at and weak at, and then gave you the opportunity to make corrections. In real life, people without financial statements, or report cards, cannot make corrections if they do not know where they are that month, that quarter, or that year. Think of your financial statement as your report card, and work diligently to eventually have your financial report card measured in millions or maybe billions of dollars. That is why your bookkeeper is important.

Your bookkeeper gives you your report card once a month.

Here are three steps to follow:

- Find and hire a bookkeeper.
- Have an accurate accounting each month of your financial condition.
- Review your financial statements each month with your advisor so you can make corrections quickly.

Team Sports

The B quadrant and I quadrant are team sports.

One of the reasons people from the E and S quadrants occasionally have trouble transitioning is because they are not used to having a team assisting them with their financial plans and financial decisions.

As a child, I noticed that my poor dad shouldered the financial problems all by himself.

He sat quietly at dinner if he was troubled, argued with my mom if he was frustrated about money, and sat alone late at night trying to make ends meet. There were many times I came home to find my mom crying because she knew that we were in financial trouble, and she had no one to talk to. When it came to money, my dad was the man of the house, and he never discussed his financial challenges with anyone.

My rich dad, on the other hand, would sit around a table in his restaurant, surrounded by his team, and openly discuss his financial problems.

Rich dad said, "Everyone has financial problems. The rich, the poor, businesses, governments, and churches all have money problems. What determines if someone is to be rich or poor is simply how well he or she handles those problems. Poor people are poor simply because they handle their money problems poorly." That is why rich dad discussed his money problems openly with his financial team.

He said, "No one person can know everything. If you want to win the game of money, you want the best and smartest people on your team."

My poor dad lost because he thought he should know all the answers—and he didn't.

After your bookkeeper gives you your monthly financial statements, meet with your team on a monthly basis. You may want a banker, accountant, attorney, stockbroker, real estate broker, insurance broker, and others. Each professional comes to the table with a different set of eyes and different ways of solving your problems. Just because many opinions are offered does not mean you have to follow any of them.

It's important that you do not keep your money problems a secret, you listen to people smarter than you in different areas of expertise, and ultimately, you make your own decision.

When people ask me how I learned so much about money, investing, and business, I simply reply, "My team teaches me." I have learned more about business and investing outside of school simply because I use my life as my real-life school. I have found that I am more interested in solving my own problems than sitting in school trying to solve fictitious ones.

The following is an example of how I use my team to teach me: The other day, I met with one of my attorneys who tried to explain how to use government tax-exempt bonds.

His explanations were way over my head, and his vocabulary was filled with words I have never used before.

Rather than waste his time sitting there pretending I understood, I stopped the meeting and scheduled another. That the next meeting, my accountant and this attorney sat down with Kim and me. The two of them helped explain what he was saying to us, in words we could understand.

I said earlier that words are tools for the brain. Each profession uses different words. For example, attorneys use different words than accountants or bookkeepers. By investing the time to fully understand the words and by having the meanings translated for me, I am better able to use the words and make those words a part of my life. In other words, I use the different professionals as translators so I can use their words in my life. The more words I can understand and use, the faster I can make more money and the better my financial future becomes.

That meeting cost me a few hundred dollars in fees, but I know the return will be exponential. It helped me understand how to borrow tens of millions of dollars from the government that very low interest rates. The combined education from my attorney and my accountant on this subject will greatly accelerate my leverage ratios. As I said earlier, you can increase your income incrementally or exponentially. By investing in my vocabulary and understanding, my wealth will increase exponentially.

So start gathering your team.

If you cannot afford a high-priced team, you may want to find a retired person who enjoys helping and guiding people. Many times, all you have to do is buy them lunch. You would be surprised how many people simply enjoy being asked to share their life's experience in order to help others. All you have to do is be respectful, not argue, and listen intently. Do this once a month, and your future will be enriched forever.

The List

The following lists include all the people and professionals you will eventually have on your team and how to evaluate and select them.

While the lists may appear overwhelming, understand that you will accumulate these contacts over time, and you don't need all of them at all times. There's no need to run out and start interviewing paving companies, for example, when you don't have a parking lot that needs resurfacing.

You just need a few key team members to get started—an attorney, an accountant, a real estate broker, and a property manager.

But here are the full lists to get you prepared:

The Business Team

Before you do anything - even print your business cards and letterhead - get your business set up correctly. To do that, you'll need to talk with an attorney who will advise you about setting up your company. Should you set up a corporation, a limited liability company, or some other business entity?

You'll need to know the pros and cons of each to make that decision. Regardless of which you choose, having a formal company established will protect your personal assets and provide tax advantages to you. If you need more information before choosing your own business team, you should contact:

- Your own attorney: you'll need this person to file the paperwork with the corporation commission. There are do-it-yourself kits, but unless you know what you're doing, I advise against them.

- Your own accountant: this person will be able to give you tax advice based on your own personal financial situation.

The Property Search Team

The property search team includes people you will most likely have to find on your own. I recommend interviewing several professionals in each field until you find people you like, who know the market, have your same level of integrity, and who understand they are there to help you achieve your goal.

Both of these professionals can also help you establish the rest of your team especially for the property inspections commonly called due diligence once you get into escrow.

- Real estate broker: the real estate broker will help you understand your market and help you find properties.

- Property manager: this person will help you assess the properties you are considering from an operational perspective. They will give you a solid idea of what you are getting into.

The Offer Team

Your property search team will most likely refer some or all of these professionals to you as you need them. That's another reason why who you choose as your real estate broker and your property management contacts are so critical. They set the tone for your entire team and therefore your entire work experience.

Choose wisely!

- Attorney: your attorney will certainly help you set up your business, but he or she will also help you wade through letters of intent and purchase and sale agreements.

- Lender or mortgage broker: find a lender or broker who understands the business of property investing. Not only will they lend you money, but they will also provide you with leads on other properties that are ripe for sale.

- Investors: by communicating your goals and doing the work of building your team, you should find several sources of equity who will entertain investing in rental property.

- Contractor/Rehab specialist. Contractors see things you and I don't when it comes to walking a property. Before I sign any deal, I have a contractor perform a detailed inspection and file a report of all critical and noncritical repairs.

Other Team Members

From time to time, you may find you need these professionals to assist with projects that arise when either considering a property or once you own it. As with the professionals on the previous list, these team members will come to you through referrals.

- Appraiser: an appraiser is an important team member and should be a person who specializes in both your market and the types of properties you are targeting. This professional will help you determine the appraised value of property before and after the sale.

- Architect: some properties need more than just a coat of paint and the bushes trimmed to get them into shape. An architect can help you with new design ideas and renovations to increase curb appeal and operations performance.

- Insurance agent: the insurance agent will help you place the proper protections when you own the property. Having the right coverage for the right price will be necessary if you acquire property.

- Property tax consultant: property taxes are realities in this business and property tax consultants can ensure that your taxes are being assessed fairly and accurately.

- Income tax consultant: the tax laws are complicated and it is always good to have the advice of someone whose job it is to keep up with tax law.

- Estate planner: as your real estate assets grow, an estate planner can help you shelter and dispose of them in the event of illness or death.

- Surveyor: as you are rehabilitating a property, you may need the services of a surveyor to assess boundary lines, elevations, and other such matters.

- Structural engineer: your contractor may find a problem that jeopardizes the structural integrity of the building. Call in a structural engineer, who will analyze the problem and recommend a strategy to repair the building.

Teams are just that: People who work together to get the job done.

They should be on your side and have the mentality that when you are successful, they're successful. Keep searching until you find people whose goals and business methods gel with your own.

Now What?

Looking back, all the lessons I've written about in this book played a vital role in my personal journey to financial freedom.

Each lesson I learned from rich dad, from others (and the hard ones I learned on my own) created a small but fundamental shift in the way I invested. And ultimately, each one played a role in how I was able to free myself from the drudgery of work that plagues most real estate investors.

The great thing for you now is that you can take what you've learned here and copy it:

- How I invest...
- How I build teams...
- How I put deals together...
- How I leverage systems and people...

Copy all of it. Read this book again and try to read it once a year. Use it as a manual and grow your own real estate empire. That's why I wrote this. There is no need to reinvent the wheel when it comes to getting started and growing your business. I've already done it all.

All you have to do is follow in my footsteps.