



FACT. or *fiction*

**Does "No Money Down"
Really Mean No Money?**

By Darlene Greene

I. Introduction

You may have heard the phrase "no money-down real-estate investment" and wondered how it was possible. A major investment in real estate with no money? Real-estate gurus may push the benefits of such investments without fully informing you of what hidden dangers lurk in the process. Don't be one of the investors who jumps on the "no money-down" train and, as a result, risks financial ruin.

As a mortgage broker and real estate investor, I have learned much about real estate investing through working with other investors and my own investments. Some investors realize too late that they are facing serious financial problems because they had inflated expectations about their returns and insufficient financial planning from the beginning. "No money-down" real estate investment might be an attractive bargain now, but could turn into a costly financial drain just months down the road.

II. What does "no money-down" really mean?

"No money down" is a marketing catch phrase designed to focus your attention on buying property for residential purposes with no money out of pocket. People who pursue that vision quickly learn that they will have out-of-pocket expenses if they go into such investments with their eyes closed to the realities of home ownership.

Not all real-estate investments are the wrong choice. I can tell you that from my own experience and that of my clients. The goal in this discussion is not to scare you away from this market, but to get you thinking critically, making sound business decisions as you invest, and asking the

right questions at the right times. Real estate can be a sound, healthy investment, just like

401(k) plans or the stock market, but proper planning and awareness are the keys to success.

There is a simple bottom line with real-estate investing: no investor should put him or herself in a position where the cards are stacked so high that even the slightest breeze can knock them over. Improper real-estate investments,

especially multiple investments at once, can lead even a prudent, generally risk-averse investor into dire straits if he or she doesn't anticipate the possible perils.

“The goal in this discussion is not to scare you away from this market, but to get you thinking critically, making sound business decisions as you invest, and asking the right questions at the right times.”

III. What the "no money-down" gurus aren't telling you

When "no money down" real-estate gurus talk about incurring absolutely no costs, they are often referring to loans that offer 100% financing. What the gurus don't tell you is that (1) these loans can be very expensive; (2) you must possess superior credit to qualify; (3) you still will have out-of-pocket expenses even though you are not making a down payment, which is what many of the investment gurus focus on to the exclusion of other important information that you need to know. These expenses include certain fees associated with the acquisition of any property and mortgage, including lender fees and closing costs, among others.

If you purchase a property intending to lease or rent it to tenants, your risks with 100% financing are increased in comparison to your risks with buying a property, rehabbing it, and re-selling it within a short period of time. Remember, not only must you cover your mortgage to break even, but you also need a positive cash flow to cover other expenses that inevitably arise.

IV.

Why do I need a positive cash flow if I am recovering the cost of my property?

Positive cash flow means you're making enough money to cover your own payments plus \$200-250 minimum for additional expenses every month. Otherwise, if something goes wrong, like needing to replace the furnace at a property, you'll have to spend out of pocket, possibly digging into your own living expenses to cover maintenance costs. A sound investment means that the property is self-sustaining once you have a tenant in place so that the income on the property covers all expected and unexpected expenses.

For some reason, people forget all the incidental and unexpected large expenses a property can generate. It's never a question of "if" the property will consume more money, but "when." Unfortunately, there are real estate investment gurus who are all too willing to motivate you without properly arming you against the potential financial risks. My advice is based on simple directives learned from my experience and those of my clients.

When you buy a car, you know that there will be expenses relating to driving and ownership outside the cost of the car: gas, lubes, inspections, insurance, and new tires, just to name a few. The same considerations apply to property purchases and taking a mortgage. Investors must figure in such comparable costs for their budget and plan appropriately. Unless they do, they will operate at a loss.

If you are an investor who owns only one investment property, has a secure, well-paying job, and savings, the fees associated with a mortgage and property, as well as unexpected costs, will not hit you so hard. But if you are the owner of several such properties and the furnace goes in one place while a tenant bails in another, you will be in trouble if you kept a tight budget for yourself without anticipating the need for "emergency" funds.





Here's a far safer option for newer and more risk-averse investors: buy one property strategically. Get the 100% financing with "no money down." Rehabilitate the house for the market you are targeting and set a budget. For example, if you research and budget \$10,000 for rehabilitation, stick to it, and make sure it's money you already have. If you've done your research properly for your target market, you should be able to sell the house at a price that not only will cover the purchase price and your expenses, but also will easily garner \$30-50,000 more. Now that's a sound deal.





Hold your horses: Use caution and check your assumptions

Many "no money-down" real-estate investment courses don't teach you how to be a discriminating investor, let alone a discriminating consumer of information. Instead, these courses and informational products are designed to motivate you to jump right in, but it's all too easy to get emotionally caught up in the hype and enthusiasm that these gurus seek to generate. Their inspirational stories might give you plenty of hope, but beware of the misleading effect they can have on your projections and planning. You still need to read the "fine print." It's understandable that people grow emotional about real estate, but investments are about numbers. It has to be about business and not your emotions, so it's important to know which assumptions are emotionally-based and should be changed:

-  1. Don't let your feelings about the aesthetics of a property undermine your business savvy. If your research has shown that a property can sell for a certain amount, don't overlook a property because of its finish, landscaping, or interior design. Not only can such things be changed without a major construction effort, but you never know what potential buyers' tastes may be. If the numbers for your investment and the property's sale add up favorably, your tastes don't matter.
-  2. No one owns a crystal ball. As with the stock market, experts can make educated estimates about future trends, but no one can guarantee you anything. If you literally are banking on the market making a certain turn and tightly budgeting around that prediction, you easily could end up in trouble. The best route you can take to protect yourself is to plan for the worst-case scenario: realize that there will be small out-of-pocket expenses (e.g., repairs) as well as significant expenses from disasters or replacements. Insurance may cover some of those costs, but there is still a deductible to pay, which is usually higher on investment properties, and increasing rates to consider.
-  3. Realize that your risk of financial trouble increases exponentially once you have more than one or two properties, regardless of what assurances you may receive from the motivational stories told by "no money down" gurus.
-  4. Don't assume that small repairs like a broken shutter or clogged sink simply will take care of themselves if you have tenants. Unless you are handy yourself, you will need someone to be responsive to your tenants' property issues as they arise. Consider what you can and can't do. Are you able to fix the toilet beyond using a plunger? Will you get up on a ladder to detach and replace a shutter? If not, you'll need to adjust your cost estimates in the beginning to include a reliable repairperson. Budget a minimum of \$50 per hour for ongoing repairs.



IV. Conclusion

You can plan for a sound financial future if you manage your risks properly. As I've pointed out, you first need to know what those risks are since many are not obvious, even to experienced investors. Unfortunately, there are no money-down real-estate investment gurus who are all too willing to motivate you without properly arming you against financial collapse. My advice is based on simple directives from my years of experience in mortgage brokering. If you would like know more about these issues, visit my websites:

www.premiermortgagesource.com

www.SimpleTheBestLoans.com

Copyright © 2005 Premier Mortgage Source Inc., All Rights Reserved

Premier Mortgage Source Inc 1900 Byrd Ave Suite 100 Richmond, VA 23230-3033

Toll Free Phone: (800) 697-9873 Fax: (804) 377-9354

These materials do not constitute legal, compliance, financial, tax, accounting, or related advice.

The end user of this information should therefore use the contents of this program and the materials as a general guideline and not as the ultimate source of current information and when appropriate the user should consult their own legal, accounting or other advisors. Any case studies, examples, illustrations cannot guarantee that the user will achieve similar results. In fact, your results may vary significantly and factors such as your market, personal effort and many other circumstances may and will cause results to vary.