RICH DAD'S GUIDE TO INVESTING WITH OTHER PEOPLE'S MONEY

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Rich Dad's Guide to Investing with Other People's Money

Introduction

One of the most important tools for gaining mastery of wealth and ensuring personal prosperity is Other People's Money or OPM. This is just what it sounds like—money that belongs to other people. How can it help you to join the rich? Easy. By investing with OPM, you can control much larger assets. Controlling more and larger assets lets you boost cash flow faster, more reliably and, ultimately, more effectively than if you used only your own money. So, strange as it may sound, using what isn't even yours is essential to your investing success.

OPM gives an investor the power of leverage. Perhaps the easiest way to understand it is by visualizing a playground teeter-totter or see-saw. With a teeter-totter, one child sits on one end of the board and one child sits on the other end. Children of roughly equal size can easily lift themselves by pushing off the ground with their feet.

But, by sliding up or down the board to change the leverage point or fulcrum, even very small children can easily much lift larger kids. That's leverage on the playground, and it works the same way in investment.

Rich dad taught Robert about the ability to "lift" large investments by using Other People's Money or OPM. "Leverage is the reason some people become rich, and others do not," rich dad said. He went on to point out, "The reason less than 5 percent of all Americans are rich is because only 5 percent know how to use the power of leverage. Many who want to become rich, fail to become rich because they abuse the power. And most people do not become rich because they fear the power of leverage."

To get a feel for the power of leverage, consider an investor with $10,000. She could invest $10,000 in the stock market and control $10,000 worth of assets. That's an example of leverage-free investing. Or she could use the $10,000 as a 10% down payment on a property and use OPM, in the form of a mortgage, for the rest of the purchase price. Then she would control a $100,000 asset. This $100,000 asset can generate much larger cash flows than a $10,000 asset. The fulcrum of OPM allowed the investor to invest more than she would have been able to otherwise and therefore increase cash flow. That's leverage in action.

However, keep in mind that leverage can hurt you as well as help you. The difference is whether one applies it to good debt or bad debt. Rich dad said, "There is good debt and bad debt. Good debt makes you rich and bad debt makes you poor." Bad debt is debt that does not increase cash flow or that reduces cash flow. Bad debt is charging a restaurant meal on a credit card, or buying a boat on an installment plan. Good debt is using OPM to pay for new production equipment that increases a business's sales and profits, or purchasing a property that can be rented to generate positive cash flow.

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Unfortunately, most people are loaded with bad debt. Others, equally misguided, live in fear of debt and strive to be completely debt free. Neither approach is best. While bad debt can put and keep you in the Rat Race, good debt can break you out. This is why Robert loves good debt. With the leverage afforded by good debt and OPM, he can do more with less. And so can you.

Your Leverage Financing Toolkit

There are several different ways use leverage and tap OPM. This section will help you understand what some options are and what you need to know in order to use them effectively.

Traditional Financing

Traditional financing sources are the ones most people think of when they need to finance a purchase. Traditional financing is common, familiar, and can be easy to get. Because of how readily available traditional financing can be, the financially uneducated are often tempted to use it to buy doodads or liabilities. For this reason, always be confident that whatever you finance puts money in your pocket every month. Financed doodads or liabilities equal bad debt. Investments that put money in your pocket equal good debt.

Conventional/Bank Loans – This source includes mortgages, auto loans, home equity lines of credit, and other bank loans. Bank loans can be divided into two categories: secured or unsecured. A secured loan has some type of collateral backing up the loan such as a home or a car. The lender can seize the collateral in case the loan is not paid back. An unsecured loan is not backed up by collateral. The lender is making the loan based on something else, such as your character, credit history and past repayment record. A secured loan will typically have better terms, such as a lower interest rate, than an unsecured loan. Bank loans are widely available and just as widely misused by people who employ them to buy cars and other items that don't increase wealth. At the same time, they are also highly regulated and qualifying, especially for an unsecured loan, can be difficult.

Credit Cards – Credit cards are the most readily available and widely used and abused form of financing. People who don't have money often employ them to maintain the appearance of having money by charging purchases such as clothes, meals, and travel. In reality, of course, they are reducing the chances that they will ever really have money, because using OPM like this increases expenses and decreases cash flow. However, credit cards themselves are not inherently bad. Used correctly, they can tap OPM to finance an investment. For instance, a credit card can be used to finance a kitchen remodel on a rental property which in turn allows you to charge a higher rent.

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Non-Traditional Financing

Non-traditional financing may summon up an image of something shady or that operates in a gray area of the law. Not so. This is just an umbrella term for financing sources other than banks and credit card companies. Because the poor and middle-class do not understand non-traditional financing, they do not use it. However, the rich use it as often as a poor person pulls out a credit card.

Creative Financing – Creative financing happens when a buyer purchases an investment in which the seller acts as the bank. Lease option, seller-carry back, and subject-to financing are a few examples of creative financing techniques. Although the seller is both selling and financing the deal, this is not a one-sided proposition where the buyer is taking advantage of the seller. Instead, both parties need to benefit. The buyer may benefit by being able to purchase property with little or no money down. The seller could benefit by avoiding capital gains taxes triggered by an outright sale, or by receiving a steady stream of income at an attractive interest rate. In the best cases, the result is a win-win.

Peer-to-Peer Lending – Peer-to-peer lending is a non-traditional form of financing that is quickly gaining favor for those in the know. Peer-to-peer lending brings borrowers and investors together directly and cuts out middlemen such as banks or other financial institutions. The way it works, borrowers request loans using an online platform. Investors can scan the listings and back or fund as much or as little as they wish to invest. Once the loan is fully funded, the borrower gets the money and the investors get monthly cash flow as the borrower repays principal and interest.

Private and Hard-Money Lenders – Private lenders and hard-money lenders are individuals who have money and are willing to lend it to you. Private lenders are usually family members, friends, co-workers, and friends of friends. The pre-existing relationship with you and confidence in you helps influence their decision to lend you money. Private lenders may provide you with a loan because they want you to succeed. A hard-money lender, on the other hand, is interested in your loan only as a financial transaction. You may have no pre-existing relationship at all with a hard-money lender. Such a lender is likely to be much more focused on the quality of the collateral than on your quality as a person. For a hard-money lender, you'll have to provide good security and have a convincing plan for how you will use proceeds of the loan to generate enough profit to pay it back.

Angel Investors and Venture Capitalists - Angel investors are often successful business owners who have substantial amounts to lend but aren't professional investors. Angels may take on more risk than banks, provide larger sums, and also reach decisions more quickly. Angel investors are generally more relaxed and friendly to deal with. Similar to private money lenders, they may invest in a technology because they want the technology to succeed rather than just because they want to turn a profit. Venture capitalists are usually firms of professional investors who raise quite large sums of cash from other investors and institutions. They can back riskier ventures than banks, and also can provide expertise. Also unlike banks, venture capitalists may

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demand considerable control. If a venture capital firm loans you money, you may have to provide a seat or two on the board of directors for a representative of the firm. It is not unusual for venture capitalists to replace a firm's founder with a new president if an investment does not seem to be going well.

How to Decide Which Source of OPM Is Best

With all these different sources of OPM, it can be confusing to decide which way to go. Banks or venture capitalists? Angels or hard-money lenders? You can narrow the choices and increase your chances of making a smart decision by asking how you will use the funds. The answer will help determine which method is appropriate.

If you plan to purchase real estate, for instance, a seller financing or a conventional mortgage is a likely choice. That's because the long term of real estate loans, up to 30 years, isn't likely to appeal to other sources of OPM. To finance the down payment on a property, a hard-money or private lender makes sense. Angel investors or venture capitalists are most likely to provide OPM to start or purchase a business or fund development of a prototype for a new product.

The money's intended use also determines how much you need. Generally speaking, don't borrow more than the use requires. Don't forget: Loans cost interest. The more you borrow, all else equal, the more interest you pay. Borrowing only what you need helps you manage and limit borrowing expense and make sure that OPM helps rather than hurts you on your way to realizing greater personal wealth.

The Bottom Line

Other People's Money is the key to unlocking your personal prosperity. Using leverage and debt respectfully and appropriately, and applying the knowledge you have gained here about sources and uses of OPM, you can apply that key to boost your cash flow and succeed in bringing your investment plan to life.

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