How to invest with less cash down

One of the biggest myths in real estate investing is that you need a big wad of cash to invest and build your portfolio. But as *Dalia Barsoum* and *Enza Venuto* explain, there a wide range of financing options available even if you're low on cash

There are ways to invest in real estate with less down and even zero down

How much down payment do I need to invest in real estate? Can I invest with zero down? We often hear these questions from our investor clients, especially those who are just starting out with their investment career.

The standard answer is that you require 20% down to buy an investment property. While this is the general rule, there are ways to invest in real estate with less down and even zero down. In this article, we highlight those options and discuss the pros and cons of each.

Buying with zero down

There are lenders today (and yes, they are here in Canada), that would allow you to buy a primary residence or a residential rental property with technically a zero down payment.

The minimum down payment required for buying a primary residence is 5% down. The lender would basically give you back on closing 5% cash back that you can use towards your down payment. You will still be required to cover any land transfer tax and closing expenses. In order to purchase with cash back/zero-down mortgage, your credit score must be 680 or above and you have to qualify with the lender based on your income and debt obligations.

Things to keep in mind

While zero-down mortgages sound great and work well for some clients, they come with several disadvantages.

❶Interest rates on zero-down mortgages are quite higher than their counterparts requiring a 5% down. For example, a five-year zero-down mortgage today comes with a 4.75% versus a non-zero down at 2.94%. That is about $100 more every month in mortgage payment for every $100,000.

❷ With a zero-down mortgage, you are forced to lock in onto a three or five-year term and with fixed rate mortgages, your penalty is high (compared to variable rate mortgages) if you are to break the mortgage before the end of the term.

❸Finally, if you are to break the mortgage before the end of the term, you are likely required to pay back the lender the cash back that they have given you. Speak with your lending advisor before jumping into cash back/zero-down mortgages.

Vendor Take Backs (VTB)

A Vendor Take Back (VTB) is when the seller (vendor) of a property provides you with some or the entire mortgage financing for purchasing his/her property. This type of financing is more common on commercial properties (including multi residential) however you can tap into this strategy on residential purchases.

A VTB can also entail the seller covering one or more of your closing costs such as land transfer tax, appraisal, and survey or application fees.

Motivated sellers, who had their properties on the market for some time, are more willing to work with a VTB. Also, you may entice your seller to take a VTB by offering them a higher price for their property.

Things to keep in mind

If you are planning a VTB, it is important to disclose that to your lending advisor upfront so that he / she can disclose it to the lender and take your application to the right lender. If not properly disclosed, a VTB may hinder your deal at closing as some lenders do not allow secondary financing.

Despite its advantages, a VTB mortgage should be entered into with caution.

❶ It is complicated and you should always consult with a real estate lawyer to review all documentation and for due diligence.

❷ From a seller's point of view, he/she is dealing with the risk of default.

❸ From a buyer's point of view, you may find yourself having to pay off the VTB mortgage in a lump sum if the seller dies, goes bankrupt or needs to liquidate his estate.

❹ Also, always think about your exit strategy when taking a VTB.

❺ A seller may be more than willing to finance the deal for you but that may be for a reason. It may be because the property is in such a bad shape that no lender would touch it or because it has been sitting on the market for a long time (again for a reason).

❻ Before jumping onto the VTB, think about whether or not you will be able to take this property to another lender at some point and payout the VTB. It is best to speak with your lending advisor upfront and understand the reasons (if any) as to why a lender may not finance the property in its current state and what would are the things that you need to address during the holding period to ensure that you will be able to finance the deal with a lender (down the road) and payout the VTB.

Using leveraged down payment

A leveraged down payment is a down payment coming from a secured/non-secured line of credit, credit card or a gift.

❶ Gifted down payment

If you are buying a primary residence, lenders would allow a relative to gift you the down payment. You need to disclose upfront to your lending advisor that this will be the case and he/she will advise you to have the relative sign a gift letter outlining the amount of funds they are giving you.

Lenders unfortunately do not allow gifted down payments on rental properties. Having said that, they are okay if the person with the funds is added to the application and is going on title with you.

❷ Down payment from lines of credit/credit cards

Lines of credit are borrowed funds. Lenders will allow you to use funds from a secured line of credit towards the down payment and closing costs of another purchase. That line of credit has to be yours and not someone else's unless they are going with you on the application and on title.

Lenders will also allow you to use a non–secured line to purchase but they won't allow the usage of credit cards directly. If you however withdrew funds from your credit card in the form of a cash advance, you may be able to utilize that cash for purchase.

Things to keep in mind

You can use leveraged funds as long as the numbers work on your mortgage application. Speak with your lending advisor to run the math for you and advise you if your plan will work out.

Using secured lines of credit work best because lenders consider interest only payments as your monthly obligation for paying off those funds, while if you use a non-secured line or a credit card, the lenders consider 3% of your outstanding balance. This simply eats away into your lending capacity.

Let's look at an example. If you use $100,000 from a secured line towards your closing costs and down payment, this costs you $333.33 every month in terms payment in the lender's eye (regardless whether or not this is what you actually pay every month).

While if those funds were coming from a non-secured line or a credit card, your monthly payment obligation in the lender's eyes is $3000!

This higher payment on your mortgage application may work to your disadvantage as it limits how much you can qualify for in terms of a loan.

Working with joint venture partners

Joint venture partners (ie: others who are interested in investing in real estate and have funds but not the time and knowledge) are a great source for raising capital for your next investment.

Joint venturing is a very broad topic that will be discussed in more details in subsequent articles but the idea is simple. If you know how to locate and operate the right investment properties, other people with funds but lacking the time and skills may want to join forces with you.

It is much easier to sell joint investments to a partner if you can show them a track record of success. Many seasoned investors use this strategy to continue to expand their portfolios with the least amount of cash; where their partners contribute funds and the investors provide a turn-key solution for investing in real estate. Both the investor and their partners determine how they split the returns and manage the risks through what is called a "joint venture agreement".

Things to keep in mind

Joint ventures are a great way for expanding your real estate portfolio through the leverage of other people's money. Both you and your partner bring something to the table to make the investment works.

Joint ventures however are like a marriage; you want to make sure you pick the right partner and be selective about who you want to work with. The more people you bring to the table the more complex the relation tends to be and the more you have to manage.

It is highly recommended that you speak with an accountant and a lawyer who understands joint ventures prior to setting up your first one. It is also key that you speak with your lending advisor to see how to best to structure financing with your joint venture partner in the picture.

Creative investment strategies

There are various creative ways to make "quick" money in real estate using minimal funds.

Those strategies are generally riskier in nature compared to a "buy and hold" approach to investing and they are not easily found (ie: require more time and dedicated energy to locate properties and sellers that fit the strategy).

❶ Assignment of contracts

Some investors have the skills and time to locate great properties that are below market value. If you are one with these skills then Assignment of Contracts may be a strategy to consider. Under this strategy, you locate a great property that is listed or where the negotiated price is below market value, you put an offer to purchase (often accompanied with a small

> It is much easier to sell joint investments with a track record

deposit) with the right to assign the contract to another buyer.

Under this strategy, it is important that you have a line-up of potential buyers who you can reach out to in order to sell your interest in the contract, for a fee of course. The person who buys your interest is the one who would close on the purchase. Further, it is important to speak with a lawyer to help structure your contract in a way that allows you to exit the deal in case you don't find a buyer.

❷ Sandwich lease options

This strategy entails the investor being the middleman between two parties.

Party one is a landlord who would like to setup a lease option arrangement with you as a tenant on an existing property (what is also referred to as a rent to own).

Party two is a sub-tenant who wants to sub-lease (also under a rent-to-own arrangement) the property you had leased from the landlord (party one).

There are two contracts involved in this setup. One between you and the landlord and another one between you and the sub-tenant; with you as an investor making money on the "spread".

You need to involve a lawyer who is experienced in "rent to own" in writing the contracts for you to ensure that your risks are well managed. ■

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