RICH DAD®

# FREEDOM FROM BAD DEBT

A **RICH DAD** FIELD GUIDE

# INTRODUCTION

Occasionally I am asked, "Will your financial education help me? I am deeply in debt."

The answer I give is, "Probably not." Why? There are things you'll need to do before you are ready for my financial education. First, play *CASHFLOW*®, learn its lessons and second, read this book and follow the program inside.

Here's why: There is good debt and bad debt. Bad debt is nasty. Bad debt is why the economies of the United States and many countries around the world are stagnant, depressed, and dying.

Bad debt is a sign of deeper problems, most often emotional ones. Bad debt is often just the tip of the iceberg. Bad debt is just the product of the real problem, being controlled by your fear or your greed.

Emotions are the biggest cause of financial problems. As Warren Buffett often says, "If you cannot control your emotions, you cannot control your money."

Rather than sign up for our financial education or read a bunch of our books, I would recommend you play *CASHFLOW* the game with like-minded people a number of times. That experience will help you discover the true reasons that cause you to be deeply in debt.

Games often identify true behaviors and mindsets. Once you have a better understanding of your situation and its causes, you will be able to make better decisions about your financial future. You can play *CASHFLOW Classic* for free at www.RichDad.com or buy the tabletop game in our store.

Once you've learned emotional maturity from *CASHFLOW*, it will be time to study this program. Years ago, when I was nearly $1 million in debt, my wife Kim and I created a program we used to get out of bad debt. We needed to get out of bad debt—so that we could get into good debt. To learn more, and start your future of freedom, keep reading.

Chapter One

# HOW BUYING AN EXOTIC CAR CAN MAKE YOU WEALTHIER

## *Good Debt vs Bad Debt*

There is good debt and bad debt. There are some rules of thought that dictate that *all* debt is bad. I obviously disagree. Again, if you have emotional maturity and can control your emotions, you can control your money. To easily make the distinction, good debt puts money in your pocket and makes you wealthy; bad debt takes money from your pocket and makes you poor. More specifically, good debt is debt on which someone else makes your payments, and bad debt is debt you pay for. An example of good debt is a loan on a rental property where your tenant pays rent and the rent covers your mortgage and expenses; this puts money in your pocket. Examples of bad debt would be a car loan or the mortgage payment for your home; these take money out of your pocket.

Rich dad said, "The rich have more debt than the poor. The difference is that they have good debt, and the poor and middle class are loaded up with bad debt." Rich dad went on to say, "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 wealthy beyond their wildest dreams. Debt has the power to make you very wealthy, and it also has the power to make you very poor."

## *Harnessing the Power of Debt*

There are many reasons that I do not join the bandwagon that says, "Cut up your credit cards, get out of debt, and live below your means." I don't say those things because I don't think that advice solves the problem for anyone who wants to become wealthy. For people who want to have a lot of money and enjoy the lifestyle that money can bring, simply cutting up your credit cards and getting out of debt does not solve that problem, nor does it necessarily make people happy. On just basic financial principles, I do agree that cutting up your credit cards is good advice for most people. But simply getting out of debt does not work for anyone who wants to become wealthy and enjoy life. If a person wants to become wealthy, a person needs to learn how to respect the power of debt, know how to get into more of the right kind of debt, and learn how to harness the power of debt. If people are not willing to learn how to respect and harness the power of debt, then cutting up their credit cards and living below their means is great advice. Either decision has a price tag attached.

## *A Great Used Car*

A friend of mine came to the house a long time ago to show me his new car. "I got an amazing deal," he said. "I only paid $3,500 for it, put in $500 for some parts, and it runs great. I could easily sell it for $6,000." He then said, "Come on. Sit in it. Take it for a spin." Not wanting to be rude, I did as he requested and took the car for a ride around the neighborhood. At the end of the test drive, I smiled and said, "It's a great car." Silently, I said to myself, "It needs a paint job, the interior smells of old cigarettes, and I would not want to own such a depressing vehicle." Taking back the keys, he smiled and said, "I know it's not a thing of beauty, but I paid cash for this so I have no debt." As he drove off, thick smoke poured from the exhaust.

## *If You Want to Become Wealthier, Buy a New Car*

Kim drives a beautiful Mercedes G550 SUV. Among others, I drive a Porsche convertible. Even when we were broke, we drove a Porsche and a Mercedes, or other nice cars. We did not pay cash. We borrowed money to buy them. Why? Let me explain with the following story, a story I often tell. It is a story about good debt and bad debt and enjoying the finer things of life.

In 1995, I received a phone call from my local Porsche dealer. He said, "The car of your dreams is here." I immediately drove down to his showroom to look at a 1989 Porsche Speedster. I already knew that there were only 8,000 of this model made over a three-year period. In 1989, Porsche devotees were buying them, putting them on blocks, and storing them. If you could find a collector who would sell one, the asking price was $100,000 to $120,000 in 1989. But in 1995, I was looking at the rarest of all the 1989 Porsche Speedsters. This was Speedster Number 1, the first ever built of this model, and it had the Porsche turbo body, which means little except to a dedicated Porsche fan. Since it was the first one built, it was the model that the factory toured all over the world at auto shows and was the car used for the photo on the brochure. The car also came with a special plaque from the Porsche factory. In 1989, after the tour was over, this car was also put up on blocks and stored in a warehouse. When a collector decided to sell it in 1995, the dealer called me. The dealer knew it was the car I had been looking for. The car may have been used, but it only had 2,400 miles on it.

Kim watched me go into a hypnotic state as I walked up to the car of my dreams. I sat in the car, took hold of the steering wheel, and inhaled deeply, smelling the rich scent of leather, which was still with the car. The car was absolutely flawless, and the color was perfect, a shade Porsche calls "metallic linen." Kim looked at me and asked, "Do you want it?" I responded with a nod of my head and a smile.

"Then it's yours," Kim said. "All you have to do is find an asset to pay for it." Again I nodded, inhaled the rich scent of leather one more time, climbed out of the car and smiled. It was the car of my dreams and it was mine. We put a deposit on the car, arranged financing with the dealer, and I went out to find the asset that would pay for the car. In other words, I was going to find an *asset* to pay for my *liability* and use *good debt* to pay for the *bad debt*.

A little over a week later, I found a great piece of property—a mini storage project in Texas—borrowed money to buy it, and the monthly cash flow from the property covered the monthly car payments for the Porsche. Five years later, the Porsche was paid off and I still had the cash flow from the property. In other words, instead of getting poorer from having an expensive liability, I became wealthier *and* got the car of my dreams, which is still mine today. We did the same thing when my wife found the Mercedes of her dreams.

Instead of saying, "I can't afford it," I said, "How can I afford it?" I encourage you to do the same.

Chapter Two

# THE BEST THINGS IN LIFE ARE FREE

There is a saying that goes, "The best things in life are free." And I agree. A simple smile can make so many people happy, and a smile costs nothing. A pat on the back with the single word, "Congratulations," costs nothing and it can brighten up a person's whole day. A sunrise or full moon costs nothing to appreciate. So in my opinion, the best things in life are free.

What I am talking about in this section are the finer things in life that cost money. The kind of happiness I am talking about is the happiness one finds from material things. I am not writing about inner happiness because material possessions cannot give you that. Inner happiness is free—and priceless if you have it. While each of us has free access to our own inner happiness, not all of us find it.

## *The Importance of Standard of Living*

If I were in high school, my friend's $3,500 bargain mobile would have been my dream car. I would have driven that car with pride and showed it off to all my friends. But when I was in my forties, driving around in a cheap car was not my idea of a dream. At issue is something called your "standard of living," which is a measure of your material happiness and satisfaction.

There are three reasons why being aware of your material happiness or changes in your standard of living is important:

1. **Your standards change.**
   As we age, our standards change because we are changing. If a person finds their tastes improving but their ability to afford their change in taste do not change, that person may begin borrowing and increasing their share of bad debt in order to afford these changes. If your standards change, especially to the more expensive side, it is important to find ways of increasing your income in order to afford those changes.

2. **It is important to respect these inner changes in material standards.**
   A person's inner happiness can be affected if their material standards change, but the person is not able to keep up financially with these changes. For example, I might be a happy high school boy with a $3,500 used car, but I would be an unhappy adult driving the same car

I dreamed of in high school. Today, I meet many people who lack inner peace because they have not kept up with the changes in their desire for the finer things in life. I meet many people who are unhappy, living below their means, trying to be happy by only buying things that are cheap and affordable, but below their personal standards.

3. **It actually costs less if you buy what you desire.**
   I am very happy with my car, and Kim is happy with hers. We may seem that we've spent more in satisfying our material standards, which includes our house and clothing, but, in the long run, we actually spend less in time and money because we're able to buy what we want.

## *Lessons Learned*

Years ago, my rich dad said, "Some people believe that God wants us to live frugally and avoid the temptations of the finer things in life. There are other people who believe that God created these wonderful things for us to enjoy. It is up to you to choose which view of God you want to believe in."

I share the story of my Porsche because I want you to have the wonderful things this world has to offer—without sacrificing your financial well-being and winding up in financial hell. And I tell the story for the lessons that follow about abundance.

Chapter Three

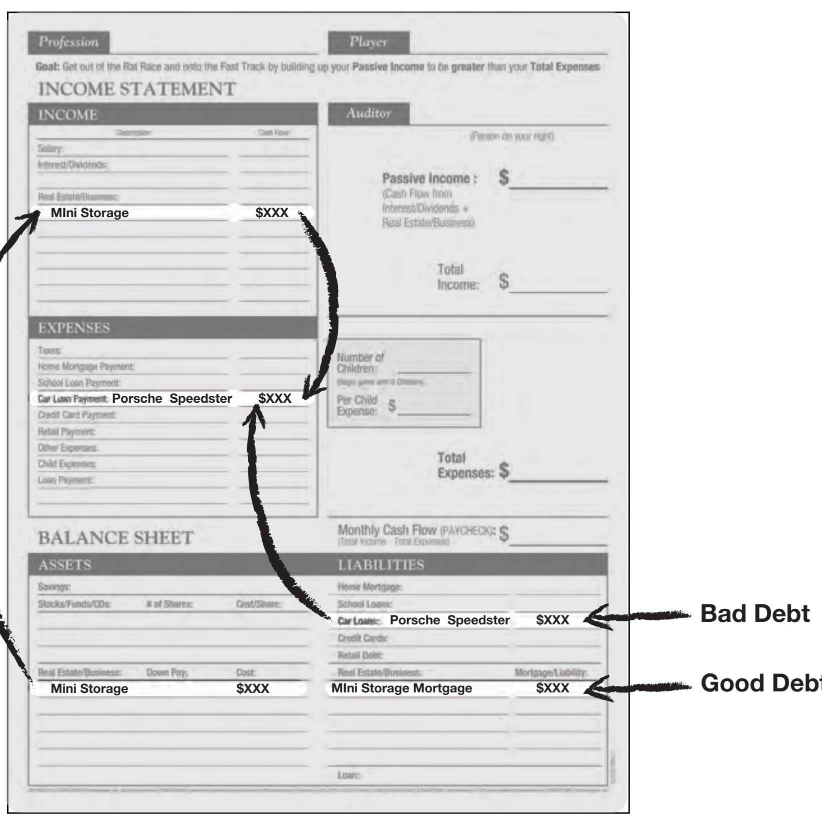
# CONTROL YOUR DEBT CONTROL YOUR LIFE

Whether it's good debt or bad debt, the more control you have the easier your life is going to be. If you want to accumulate more cash-flowing assets, then you'd better improve your ability to control debt. Below I share some lessons on debt, mindset, what banks like, and the power of leverage:

### Lesson #1: The Importance of Good Debt and Bad Debt

Rich dad stressed the importance of financial literacy and the fact that your financial statement is your report card once you leave school. The following financial statement shows my assets buying my liabilities in the Porsche transaction.

**My Assets Buy My Liabilities**



As you can see, I borrowed money for both the Porsche and the mini storage investment in Texas. The cash flow from the investment covered the monthly costs of the Porsche. Because of good management, the cash flow from the mini storage greatly increased and the Porsche was paid off two years early. Today, I have the real estate, the cash flow, and the Porsche. We used a similar process when buying her Mercedes. We ultimately became wealthier when we bought the cars of our dreams.

Our friends, a couple who live above their means and who drive the cars of their dreams, get poorer instead of richer because the income from their jobs is their only source of income. Their expenses increased (dramatically) but their income didn't increase at the same time. They look good physically on the outside, but I suspect that financial worries from bad debt are eating them alive on the inside. They are buying liabilities with bad debt instead of buying assets with good debt.

Buying assets with good debt that provide the cash flow for paying for the liabilities you want in life is what rich dad taught me. The cash flow from your assets represents your money working for you, something my old friends, and many people today, still do not understand.

## *Whom Are You Really Working For?*

When it comes to good debt versus bad debt, let me repeat what rich dad often said to me: "Every time you owe someone money, you become an employee of their money." That is, if you take out a 30-year loan, you've instantly become a 30-year employee for the bank. Unfortunately, they do not give you a gold watch when the debt is retired.

Rich dad did borrow money, but he did his best to not become the person who actually paid for the loans. That's the key. His advice bears repeating: Good debt was debt that someone else paid off for you, and bad debt was debt that you paid for with your own sweat and blood. His love of rental properties was based on "the bank gives you the loan, but your tenant pays it off for you."

Let me use a typical real-life example to illustrate just how this works. Assume that you find a nice little house for sale in a decent neighborhood. True, the home needs some fixing up—perhaps a new roof, new gutters, and maybe a new paint job. But by and large, it's surrounded by other homes that are fairly well maintained, the neighboring area is solid, and the schools are good. Even better, the neighborhood is right next to a local state university which is always looking for more student housing as the campus enrollment continues to increase year after year.

The homeowner wants to retire and move to someplace warm and sunny. He's asking $110,000 for his house. You negotiate a bit with him, and you finally settle on a price of $100,000. You already have $10,000 saved up in your bank account, so you need to get a mortgage for at least $90,000. But in truth, since that $10,000 is pretty much all the cash you have on hand, you decide to apply for a $100,000 mortgage. Why? Because with that additional $10,000, you can pay off the bank's closing costs as well as pay a local handyman to paint the house and repair the roof and gutters.

In many cases, the bank will be happy to give you the mortgage. Why? Because the mortgage is secured by the collateral value of the house. If you went to a bank and asked for a loan of $100,000 and you didn't have any collateral or secured assets to back it up, the bank would tell you to take a hike. But with the house property backing you up, the bank will usually help you finance the loan. Remember, the bank is in the business of making loans—and will do so when they know that there's real collateral to help secure that loan.

Let's move on. Under current finance rates, the bank gives you a 30-year mortgage at a rate of 6 percent. First, of course, they want that $10,000 cash as a down payment, which you give them. So, in addition to the $100,000 mortgage, your total investment is now $110,000.

Once you figure in your property taxes, your monthly mortgage payment is going to be about $700. But as mentioned before, you don't want to be an employee of that bank loan for the next 30 years. As long as you have that debt service, you're working for the bank. The better approach is to have someone else pay off that debt for you.

Rich dad would suggest that, once you close the deal and own the home, you then start talking to the local university about the possibility of students renting your home. Let's say that you charge $1,000 a month for the rent. If the home has four bedrooms, it could easily accommodate four students, each of whom would pay $250 a month. That's a fairly modest amount, even for the most cost-conscious student.

Or, you can simply check with a local real estate agency to see if they can handle the rental of your property. For a small monthly maintenance fee, many real estate agencies will not only find a renter for your property, but will also take care of any minor maintenance issues, such as fixing a clogged toilet.

Here's more good news. If your rental property is earning you $1,000 a month, and your mortgage payment is only $700, then your monthly net cash flow is $300 a month. This net income is what is known as *passive income*. That is, you're not doing any heavy lifting or hard labor to earn it. At the same time, someone else, your tenant, is paying off your 30-year mortgage for you, and you're earning an extra $300 a month.

Rich dad's real estate investing philosophy is primarily based on cash flow. Do you have positive cash flow at the end of each month?

There is also the possible bonus of appreciation. While you're earning that extra income each month, you're also paying down your mortgage each month. That means that, very slowly but steadily, you are building more equity into the home. 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.

***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."

## *Take a Tip from Those Who Have Taken Control*

Take a look at the stories of everyday people who were fed up living paycheck to paycheck in the book, *Rich Dad's Success Stories*. They just got tired and frustrated of trying to count the years until they could retire and then theoretically live off their 401(k)s—assuming that their 401(k)s still had enough money in them to allow them to retire. In that book, you'll find easy-to-follow firsthand accounts of people—some in their teens and some nearing retirement—who followed rich dad's advice and have started to develop steady streams of passive income.

Many of those success stories are built upon real estate investing. All of the people in the book explain how they had to overcome their fear of taking that initial leap of faith to find that first investment property. But invariably, once they started to see the stream of passive income develop, they almost all went back and repeated the process again—in many cases, again and again. Some of those folks have gone on from simple single-family homes to larger, multi-family properties, and all of them point to rich dad's advice as having led the way for them.

In some of the success stories, the individuals decided to invest in small businesses in order to earn their financial freedom. One of the chapters profiles a woman who started to invest in laundromats. As soon as she and her husband found that it was a fairly safe and easy investment to make, they then invested in two more. Now, she and her husband are doing quite well financially, and they'll be the first to tell you that it was simply a matter of doing some financial homework and making their money work for them, instead of them working for money.

The point is that most people can't seem to get ahead financially because of the monthly onslaught of bills to pay. It's only when they finally make up their minds to do something about their financial lifestyle that they find the self-determination to look at other ways of generating money. And as rich dad says, "If you want to get out of the Rat Race, then you had better start learning about the different types of income: Earned, portfolio, and passive." Whether it's investing in real estate, business, or other kinds of investments, the sooner you discover that there are better ways to make money besides a job, the better off you and your family are going to be.

**Lesson #2: The Power of Inspiration**

Let's get back to the used-car story. When I drove my friend's used car, I felt depressed. Sitting in the car did not inspire me. I did not hear angels singing or see the heavens open up with blessings as they had when I sat in my Porsche. As my friend drove away with smoke pouring out of the exhaust pipe, I felt nauseated. In contrast, when I open my garage door and look at my Porsche, I still hear the angels singing. I love that car and I love the inspiration it gave me to go out and invest in another property. In other words, that car inspired me to become wealthier. Sitting in my friend's car only inspired me to take a bath.

I believe our Creator assists us humans in building beautiful things. When I see a beautiful painting or a beautiful home or a beautiful car, I feel inspired. I feel the generosity, the beauty, and abundance of God, and it inspires me to go out and invest more vigorously—by *investing* harder, not by *working* harder. I notice that people who treat themselves poorly are often not the most inspiring people to be around.

I had some old friends who were so cheap that, when I was in their house, I felt like I was in my old friend's used car. I loved my friends dearly, and I did not impose my financial views on them. They worked hard at living below their means, while Kim and I worked hard to continually expand our means. That makes a colossal difference in the way we live our lives. As I said, we are all different, and we make different choices. I am simply sharing with you how Kim and I use the luxuries of life to inspire us to become wealthier.

**Lesson #3: My Banker Loves to Lend Me Money for Both Assets and Liabilities**

My assertion in *Rich Dad Poor Dad* that your house is not an asset created a lot of controversy. In fact, I received more angry mail about that than any other point in my books. I often say, "When your banker says your house is an asset, they are not lying to you. They are just not saying whose asset it really is. Your house is *their* asset." I'm not saying don't buy a house. All I'm saying is don't call a liability an asset.

Your banker will lend you money regardless of whether you buy an asset or a liability. Your banker does not tell you which one to buy. So if you want to buy a new speedboat and your financial statement shows that you can afford the payments, the banker will be more than happy to lend you the money.

If you want to buy a three-bedroom home that you'll use as a rental property that makes you money and your financial statement is favorable, the banker will generally lend you the money. Why? Because, regardless of whether you borrow money for a liability or an asset, *they're both assets to the banker*. So people who first borrow money to buy assets usually end up with more money to buy liabilities. People who only buy liabilities often have no money left over to buy assets.

Since your banker does not really care whether you buy assets or liabilities, because either one is an asset to the bank, then maybe you should care. In fact, the more you care, the happier the banker is because the banker's job is to lend you more money, not turn you down for your loan. Bankers do not make money unless you borrow money. So the richer you become, the happier your banker also becomes. I love my banker because my banker lends me money to buy assets as well as liabilities.

**Lesson #4: What Asset Does Your Banker Love the Most?**

A radio host asked me, "What do you invest in?" I replied, "I began investing in real estate in my twenties, so the bulk of my investments is in real estate today. I also own businesses and have holdings in gold and silver."

The interviewer then said, "I don't like real estate. I don't want to fix toilets and receive phone calls late at night from tenants. That is why I don't invest in real estate. Everything I have is in stocks or mutual funds." He then ended the interview, cut to a commercial break, and I was ushered out of the studio.

## *An Expensive Idea*

Later that evening, I reflected on that interview. I said to myself, "What an expensive decision that radio interviewer has made. He does not want to invest in real estate because he does not want to fix toilets or receive phone calls late at night. I wonder if he knows how much that single idea is costing him?"

The four primary asset classes a person can invest in are:

1. Business
2. Real estate
3. Paper assets
4. Commodities

As I sat there quietly that evening, I could hear rich dad saying to me, "Which one of the four asset classes does my banker love the most?" The answer is real estate. Of the four asset classes, it is very difficult to receive a loan to start a small business. You might get a small-business loan, but those loans often require you to pledge your other assets as security.

It is also very difficult to get your banker to lend you money to buy paper assets or commodities, especially for 30 years at a low interest rate. But your banker will loan you the money to buy real estate.

Years ago, rich dad said, "If you want to be rich, you must give your banker what he wants. First, your banker wants to see your financial statement. Second, a banker wants to lend you money to buy real estate. Just know what your banker wants, and you'll find it easier to become rich."

The radio host's prejudice against real estate was an expensive idea because he will have to use his own, after-tax dollars to buy his stocks, bonds, and mutual funds without being able to leverage his banker's money. He has to use the most expensive money of all, his own money that comes from his own labor, and only after the government has taken its share in taxes.

Let's use a $20,000 example to illustrate this point. If the radio host buys mutual funds, all he can buy is $20,000 worth. If the host were to buy real estate, he could buy a $100,000 property with the same $20,000 and $80,000 borrowed from the bank. If the property has a positive cash flow, the tenant's payments will cover all expenses and the cost of the bank's mortgage and will also provide some monthly income.

Let's say the markets are good and each investment goes up 10 percent that year. The mutual funds will gain $2,000 for that investor. The real estate will gain $10,000 for the investor, plus the monthly income from cash flow, plus depreciation. If the investor chooses to sell the property, there is no capital-gains tax in America if a 1031 tax-deferred exchange is used at the time of sale.

The mutual fund probably does not have any cash flow, is not entitled to depreciation benefits, and is taxed at a capital-gains tax rate if it is outside a retirement plan. (If it is inside a retirement plan, it will be taxed at the highest tax rate of all, the ordinary earned income-tax rate, when it is finally withdrawn.)

This is not to say that paper assets are bad, but to illustrate the cost of an idea such as, "I don't invest in real estate." To me, the biggest expense of all is personal freedom. For Kim and me, the best thing about real estate is the monthly passive cash-flow income, taxed at a lower rate than ordinary earned income, which allows us to be financially free. In other words, real estate allows us to have good debt, and good debt is debt that makes us wealthier quicker. But in utilizing leverage, the bank's money, to get wealthier quicker, there is a price to pay.

If you look at the returns on your capital using no leverage, your return on $20,000 is 10 percent. But by using the bank's money, your return is 50 percent on *your* money. The real estate market would need to go up by only 2 percent to have the same return as the paper market going up by 10 percent.

When you factor in the tax advantages, the real estate market can improve by less than one percent and have the same net return as a paper asset improving by 10 percent.

Those are some of the reasons why rich dad said, "Always give the banker what he wants." And why he also issued these words of caution, "Always treat any debt as you would a loaded gun." That's because leverage can swing both ways with equal force. You can *make* a lot more money using the bank's money, and you can *lose* a lot more money using the bank's money. Investing in your education and several years of experience is necessary. If you are not willing to pay that price, do not use other people's money.

Chapter Four

# HOW MUCH BAD DEBT DO YOU HAVE? BE HONEST

Before you can start on your way to financial freedom, you first have to pinpoint exactly how much bad debt you really have. For many people, figuring out how deeply in debt they are is like going to the dentist. You know it's good for you, but it's not always pleasant. Some people have already given up; they know they're in a big hole but don't want to deal with it.

**QUIZ**

If you're serious about building positive cash flow in your life, you have to start with the fundamentals of financial literacy. Here's a quick quiz to get yourself going *(Keep track of how many you answer "Yes" to):*

____Do you routinely pay your bills late?

____Have you ever hidden a bill from your spouse?

____Have you neglected repairing the car because of insufficient funds?

____Have you bought something recently that you didn't need and couldn't afford?

____Do you regularly spend more than your paycheck?

____Have you been turned down for credit?

____Do you buy lottery tickets in the hope of getting out from under your debt?

____Have you put off saving money for a rainy day?

____Does your total debt (mortgage excluded) exceed your rainy-day reserve?

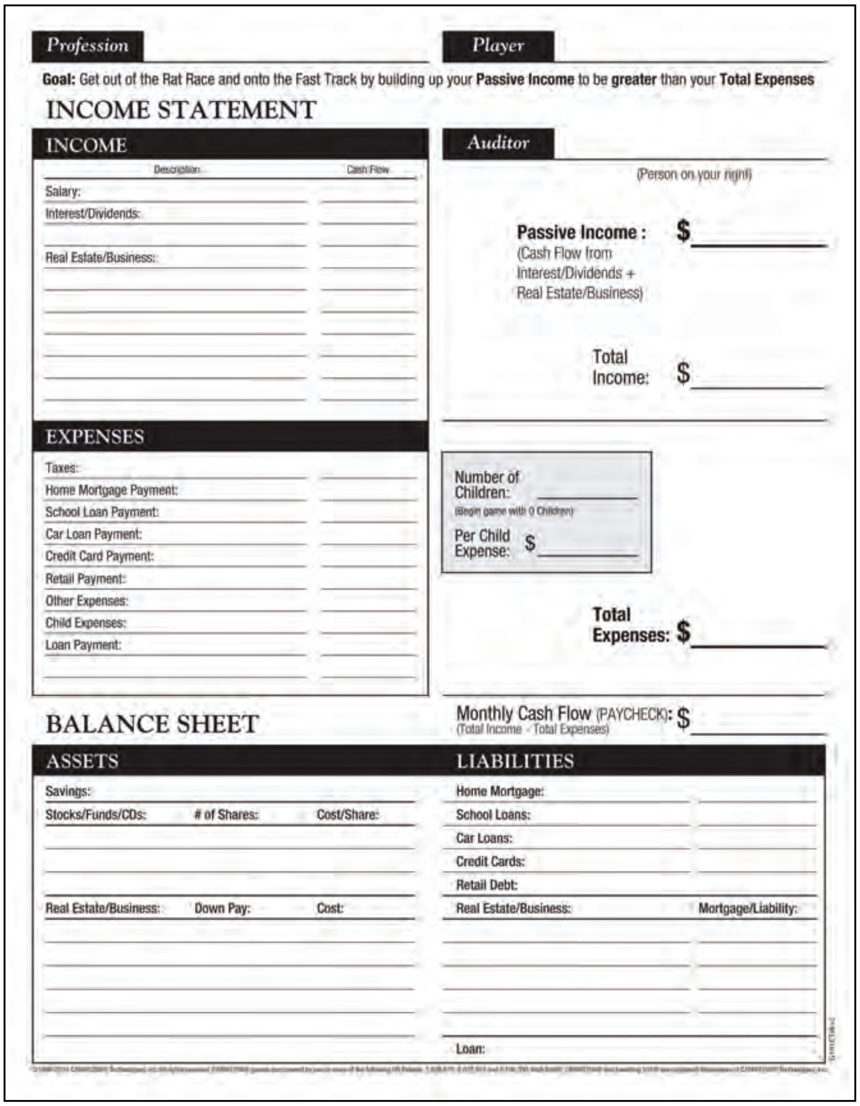
Add up the number of times you answered "Yes."

- If your score is 0, that's great! You're already in control of your cash flow.
- If you scored in the 1–5 range, you may want to think about reducing your bad debt.
- If you scored in the 6–9 range, watch out! You're likely headed toward financial disaster.

## *Rich Dad's Emergency Cash-Flow Program*

If you really want to gain control of your cash flow, you're going to need three key ingredients:

1. A financial statement to know where you are financially (Use the financial statement from the *CASHFLOW* game, included here, to fill out your own financial statement.)



Profession
Player
**Goal:** Get out of the Rat Race and onto the Fast Track by building up your **Passive Income** to be **greater** than your **Total Expenses**

INCOME STATEMENT

INCOME
Description | Cash Flow
Salary:
Interest/Dividends:
Real Estate/Business:

Auditor
(Person on your right)

**Passive Income :** $
(Cash Flow from Interest/Dividends + Real Estate/Business)

Total Income: $

EXPENSES
Taxes:
Home Mortgage Payment:
School Loan Payment:
Car Loan Payment:
Credit Card Payment:
Retail Payment:
Other Expenses:
Child Expenses:
Loan Payment:

Number of Children:
(Begin game with 0 Children)
Per Child Expense: $

**Total Expenses: $**

BALANCE SHEET

Monthly Cash Flow (PAYCHECK): $
(Total Income - Total Expenses)

ASSETS
Savings:
Stocks/Funds/CDs: | # of Shares: | Cost/Share:
Real Estate/Business: | Down Pay: | Cost:

LIABILITIES
Home Mortgage:
School Loans:
Car Loans:
Credit Cards:
Retail Debt:
Real Estate/Business: | Mortgage/Liability:
Loan:

2. Personal discipline

3. A game plan that's going to take you where you want to go

Is it difficult to change your habits? You bet it is. It will depend on you and how dedicated you are to take control of your financial life. Remember, you don't have to do any of these steps. But if you don't, you'll just remain where you are, in the current Rat Race of spending your paycheck on bills that never stop coming, or get worse.

While you don't have to cut up your credit cards, you do have to follow a debt-reduction plan. The first two steps in doing this are:

- **Pay Yourself First**
  Whenever you get a paycheck, the first bill you pay is to yourself. Not the car payment. Not the mortgage or rent money. Pay yourself a decent bit of money, and then immediately put that money into a separate investment savings account. Don't touch it until you're ready to invest it in some other way.
- **Cut Back on Doodads**
  Doodads are those extra things in life that we all crave but really don't need. It might be a fancy car or going out to dinner at expensive restaurants or really sharp clothes. Whatever your doodads are, just stop that habit of purchasing them impulsively. This is where your self-discipline and willpower come into play. If you really want to get out of bad debt, you need to adopt the old-fashioned virtue of delayed gratification.

Remember, in order to get where you are going, you must know where you are starting from. If you can't be honest with yourself on how much bad debt you have or are not willing to be disciplined, you will have no chance at becoming financially free.

Chapter Five

# HOW WE GOT OUT OF BAD DEBT!

Kim and I had a lot of debt when we started our lives together. We estimate we had a total debt of about $400,000 and growing, as interest accrued. Much of this debt came from a business I lost early on in my career. *(The total business loss was almost a million dollars. Approximately $500,000 of the debt was paid off by the business.)* On top of that burden, we went through a horrific year in 1985 as we were building our next business. It is hard enough building a business when there is not much money coming in, but it was even harder with $400,000 of debt hanging around our necks. It was not a fun way to start a life together.

In 1984, we left Hawaii. I sold everything I had and shut down my manufacturing business and we moved to California. We ran out of what little money we had in about three months. We found ourselves broke and, for a short period of time, homeless. It was the toughest time of our lives. To survive, we maxed out every credit card we could get our hands on, which meant debt was increasing again.

Fortunately, a friend let us live in an apartment in her garage as we rebuilt our lives. As those of you who have fallen behind know, it is hard to get ahead with debt hanging over your head. It was tough just buying a car, which we did at an extremely high interest rate. During this period of our lives, we worked at odd jobs just to cover our debts, to eat, and to keep a roof over our heads. We did this after we worked on our business. So, we know well what it's like to be swimming in debt. We know what it's like to struggle financially as well as endure the stress and anguish it causes.

On several occasions, we considered declaring bankruptcy, but we did not. We thought it best that we learn our lessons and pay back the money. For us, paying the money back was a wise decision because it made us stronger as a couple, smarter as investors and business people, and more confident about our future. By 1990, we were out of consumer debt and had paid back most of the $400,000 I owed investors. Today we are richer, not just because we have a lot of money—but richer from the experience and the lessons we learned digging our way out of debt.

## *If You Are Facing Bankruptcy or Foreclosure*

Bankruptcy is always an option if you are in financial trouble. Just because we did not opt for it, does not mean it may not be a viable alternative for some people. If you do have a bankruptcy or a foreclosure on your record, there are still ways through which you can obtain credit. So if you are facing bankruptcy or foreclosure or have blemishes on your credit history, there are ways to work through it. Since we are addressing how to pay down and get out of debt, we won't address that large topic in this eBook.

### *Financial Intelligence*

Many people simply say, "Get out of debt." That makes good sense if you are loaded with bad debt. However, if you have a higher financial IQ, you may want to get into debt—good debt, and a lot of it—debt which someone else pays for and debt that will ultimately make you richer. In financial terms, good debt is often referred to as leverage. One of the reasons why we love investing in real estate is because our banker will lend us a lot of money to become richer. Try asking your banker for a loan to buy mutual funds.

**A word of caution before running out to get into good debt:** Please remember that debt is a double-edged sword. If the economy changes, good debt can change to bad debt very quickly.

### *Investing with Debt*

The bottom line is that, in order to become a successful investor, you first must put your personal finances in order. Simply said, if you have too much bad debt due to poor financial habits, please do not get into any more debt, good or bad. Once you get your personal finances in order and under control, you may be ready to go out and look for sound real estate investments to grow richer on. Remember, the problem with having too much bad debt is that bad debt makes it harder to acquire good debt. For many people, just getting out from under bad debt is enough to make their financial future brighter, even if they do not invest.

I share this story so you can realize that, no matter how deeply in debt you are, you have a chance. Yes, it's painful. No, it's not fun. But, you'll be stronger for it and the rewards are lifelong. Best of all, it sets you on a path to financial freedom.

Chapter Six

# 10 STEPS TO GETTING OUT OF BAD DEBT

If you follow the steps below all the way through, you'll be able to experience a taste of financial freedom. With the emotional fortitude and the discipline learned following these steps, you will be well on your way to having the right tools to appropriately manage good debt, along with the bad. Let's get into it.

***Note:*** Some of the following steps will reiterate what I've already said—they're just that important.

## *The Following are the 10 Steps We Followed to Get out of Bad Debt.*

**Step 1. Tell Yourself the Truth.**

The first, and probably the toughest, step of all was to commit to tell ourselves the truth—to face the grim reality of how much we owed and to whom we owed it. We knew we could easily lie to ourselves and pretend we were okay financially, which is what many people do. So, face the hard facts and hold yourselves accountable.

**Step 2. Stop Accumulating Bad Debt.**

There's a saying that goes, *"When you find you've dug yourself into a hole… stop digging."*

We basically put a freeze on all debt. Anything we purchased was paid off that month. We stopped adding to our existing credit card balances and took on no new loans. That step alone forced us to be much more cognizant of what monies were flowing out.

**Step 3. Make a List of *All* the Debt You Owe.**

Write down every single debt you owe. This may include credit cards, school loans, car loans, boat loans, IOU's to individuals such as friends and family members, store credit accounts, vacation home, and your personal residence. Do not include debt for investments, such as rental properties and business investments. And just a reminder, your home is not considered an investment. We are dealing only with bad debt, and bad debt is debt that you pay for. Good debt is debt that someone else, such as your tenants, pay for.

**Step 4. Hire a bookkeeper.**

We hired a bookkeeper. She became a valuable member of our team. People often ask, “Why hire a bookkeeper when you have little-to-no money?” The answer is simple: Because our bookkeeper forces us to face the truth of where we are financially every single month.

So we sat down with our bookkeeper, Betty, for our first meeting and made a list of every debt we had outstanding. We wanted to pull some of the debts off the list and tell ourselves that those debts weren’t important. We didn’t have to pay those back. But again, that would be lying to ourselves, so we included every debt. That was a very long and painful meeting.

When all was said and done, the number staring us in the face had grown to about $500,000 *($400,000 from Robert’s earlier business plus we accrued an additional $100,000 over the years)*. Paying off a half million dollars, when we had almost no income coming in, seemed an impossible task. We actually had people advise us that we should file for bankruptcy, but we refused to do that.

So now the question was, “How do we pay off this debt?” There are three reasons why bookkeepers are important: First, they keep accurate, neat, and orderly records. This is vitally important if you want to build wealth. Today, as our wealth grows, our bookkeeper’s role steadily becomes more important. The second reason is that having a bookkeeper was a tremendous emotional support when facing the harsh realities of our financial situation. Reason number three is simply that rich people have bookkeepers on their team.

So if you plan on climbing out of debt, staying out of debt, and becoming rich, a bookkeeper can be one of the most important people on your team. Saying it another way, poor and middle-class people do not have bookkeepers. Rich people do. So find a way to afford a bookkeeper.

***Note:*** *This is a step many people in financial trouble want to avoid. They often think they will save money by not hiring a professional bookkeeper. I know I thought that way. After my rich dad reminded me that I was thinking like a poor person, thinking I could not afford something vital to my success, Kim and I bit the bullet and hired a bookkeeper.*

## *Pay Yourself First*

We realized it was important to clean up our past and, at the same time, we needed to create our financial future. So we added one more piece to the equation.

Robert and I decided that with every dollar bill that came into our household, we would take a set percentage off the top, before paying any bills. It was vital to us that the money come to us first, instead of paying everyone first and hoping there would be something left over.

If you have read *Rich Dad Poor Dad*, then you will be familiar with our three-piggy-bank approach. We set up three piggy banks: one for savings, one for tithing or charity and one for investing. *(We used actual piggy banks.)* We then set the percentage for each piggy bank at 10% each, for a total of 30% of all income we received. If we received $100, then $10 went into the savings bank, $10 into the charity bank, and $10 into the investing bank. We did this with every dollar we received. Here is a key point. It's not the percentage or the dollar amount you commit to that's most important. You may choose to start with only 2%. What's important is creating the habit of putting this money aside every month. Robert and I had formed some bad financial habits which had gotten us into so much debt. In order to pay off our debts and build our financial future, we needed to create new habits that supported us in doing so. Today, instead of 30% going into our piggy banks, we now put about 80% of our income into our piggy banks.

## *The Steps are Simple:*

- Set up three piggy banks: savings, charity, investing.
- Decide what percentage of your income will go into each bank each month.
- Hold yourself accountable to "pay yourself first" with every dollar that comes into your home.

## *The Formula*

Once the first four steps are in place, you are ready to move on to The Formula for the elimination of bad debt. Steps 5 through 10 walk you through the specific formula that Robert and I followed to get out from under the debt we owed. If you follow these guidelines closely, you will be amazed at how quickly you will erase each debt, one at a time, from the list you put together. Robert and I paid off the debt we had amassed within five to seven years. You can too.

### Step 5. Make A Visual Picture of Each Debt.

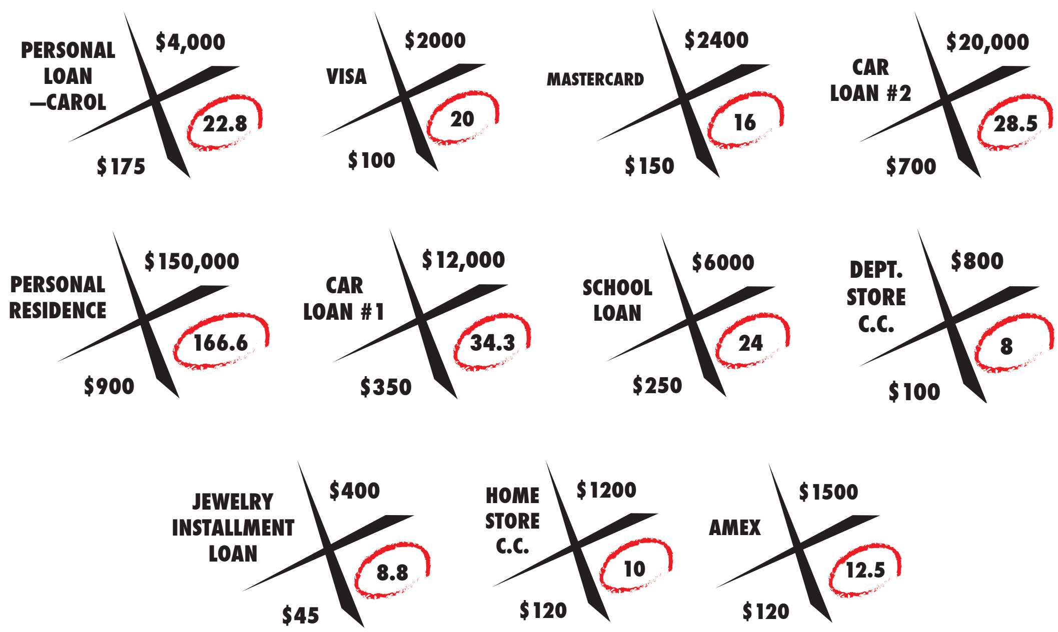
From the list you've made in Step #3, create a visual drawing of each debt. From there, you can then determine which order each debt will be paid off. The following is how you do that.

### *For Each Debt, Draw a Quadrant*

In the upper left-hand corner, write in the name of the debt. In the upper right-hand corner, write in the total balance owed. In the lower left-hand corner, write the minimum monthly payment. Now, divide the total balance owed by the minimum monthly payment. In the lower right-hand corner, write in this number and circle it in red. The circled numbers are the number of months it will take to pay off that specific debt.

For example, if you owe $2,000 on your Visa credit card and your minimum monthly payment is $100, then $2,000/$100 = 20. Write "20" in the lower right-hand corner and circle it in red.

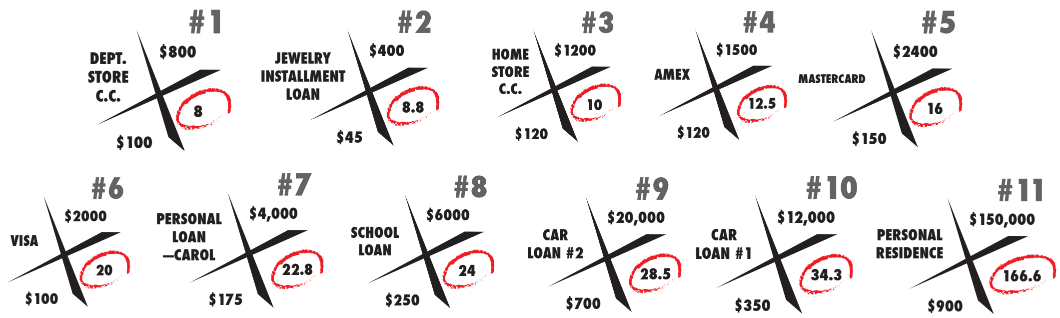
Do that for every debt on your list. If you owe money with no set minimum monthly payment, then decide what you want that monthly payment to be. When completed, your quadrants may look something like this:




**Step 6. Determine the Order for Paying Off each Debt.**

Looking only at the circled numbers of each debt, find the lowest number and place a #1 next to that debt. Find the next lowest number and write a #2 next to it. Continue to do that until there is a number next to each of your debts. Again, go from the lowest to the highest number. The circled numbers are the number of months it will take to pay off that specific debt.

*For example, if the smallest circled number you find is 8, then you would write a #1 next to it. This is the first debt you will pay off. If the largest circled number is 166.6, then this would be the last debt you pay off.*




The question I often hear is, "Shouldn't I pay off my debt with the highest interest rate first?" Not necessarily for this formula to work. The reason is this: It's important that you see some immediate results in this process. Otherwise, it is easy to get discouraged and quit before paying off even one of your debts. By paying off the debt with the lowest circled number, you are also paying off the debt that will be the quickest to pay off. So you see results quickly. You can see what you are doing is working. This visible progress makes it easier to keep moving ahead with this formula.

As you can see, you now have a clear outline of every debt you owe and the order in which you will pay off your debts.

**Step 7. Find an extra $100-$200 per month.**

This may sound a little daunting at first but brainstorm some ideas on how you could do this:

- Use your expertise and consult for local businesses.
- Find items at garage sales or secondhand stores and resell them on eBay, other online auction sites, or online classified sites like Craigslist. After all, one man's junk is another man's treasure.
- Mow lawns, etc.

Face it, if you cannot come up with an additional $100 each month, then what do you think your chances are of becoming financially set in life? Probably pretty slim. If $100 per month is stopping you, then financial freedom will be nearly impossible to achieve.

You can find ways to earn the extra money. You just have to get out of your comfort zone and get creative.

**Step 8. Except for Your #1 Debt, Pay Only the Minimum Monthly Payment for Each of Your Other Debts.**

Let me guess. You've been told if you just pay a little extra on each credit card or loan, then you will reduce your debt quicker. Is that correct? That's what I was told. However, my credit cards never seemed to get paid off. I didn't feel I was making progress or getting ahead.

For this formula to work, pay only the minimum monthly payment due on each debt and put the extra $100 to $200 towards Debt #1. Therefore, for Debt #1, you are paying the minimum monthly payment required PLUS $100 to $200 extra.

Continue doing this each month until Debt #1 is completely paid off. Go back to your chart of debts and place a big red "X" through Debt #1. Now celebrate!


**Step 9. Move On To Debt #2.**

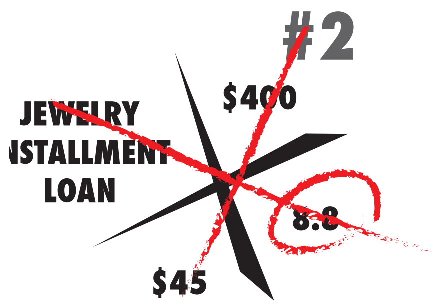
You made it through the first milestone. Congratulations! Now, turn to Debt #2. Except for Debt #2, pay only the minimum monthly payment required for all other debts. For Debt #2, pay the minimum monthly payment required PLUS the full amount you were paying on Debt #1.

For example, on Debt #2 you will pay the following each month:

- The minimum monthly payment required on Debt #2,
- The minimum monthly payment you were previously paying on Debt #1, and
- The additional $100 to $200.

Now you are paying more than simply the minimum monthly payment and the extra $100 to $200. With each debt you pay off, you will be accelerating your payments on the next debt.

Continue each month until Debt #2 is paid off. Then put a red "X" through Debt #2. Celebrate!




Move on to Debt #3. Pay the following towards Debt #3 each month:

- The minimum monthly payment required on Debt #3,
- The total amount you were previously paying on Debt #2, which included:
  - The minimum monthly payment you were previously paying on Debt #2,
  - The minimum monthly payment you were paying on Debt #1, and
  - The additional $100 to $200.

Continue each month until Debt #3 is paid off. Put a red "X" through Debt #3. Celebrate!


Continue this process for each debt, always paying the minimum monthly payment plus everything you were paying towards the previously paid-off debt.

## *The Final Results*

By following this formula, all the debts, excluding the residence, were paid off in just over three and a half years. This is over $50,000 of debt. It then took less than four and a half years to pay off the personal residence. So in just eight years, this person is completely debt-free. (The personal residence alone would have taken over 20 years if a traditional payment schedule were followed.) Now that all the debt is paid off, this person has $3,010 per month to put towards investments.

Just an extra $100 per month is the magic behind this formula.

## *Eventually Your Debt Chart Will Be Filled with X's:*


If you stick with this formula, you will be amazed at how quickly you can become debt-free. Many people report they are completely out of debt within five to seven years.

### Step 10. The Monthly Amount You Paid on Your Final Debt—Invest It!

This process does not stop once you've paid off all your debts. This is the point where you go from being debt-free to becoming rich!

Take the total amount of money you were paying each month on that last debt you paid off and invest it. Do this every month. It's very likely that the monthly amount has grown quite a bit since you started this process. Imagine having that much money every month to invest and, more importantly, to contribute towards you becoming financially free—never having to worry about money again and living the life you choose!

**A Few Bonus Tips**

- Remember this is a process. In order for this formula to work, you have to stick to it every month. If you say to yourself, "I'll go off the plan just this month," then chances are, you'll begin a habit of not following the formula and your debts will not go away.
- Do you have to be debt-free before you invest? No. This is your choice. Kim and I had quite a bit of debt when we started investing and we were also following this debt formula every single month. This formula not only answers the question, "How do I get out of debt?" It also handles the objection of, "I don't have any money to invest."
- If you are married or in a long-term relationship, Kim and I highly recommend that you go through this process together. For us, it made us stronger as a couple. We were working towards a financial goal together. If you and your partner are learning together, growing together, making money together, and most importantly, driving towards a common goal of freedom together—that makes for an exciting life together.
- Enjoy the process. Keep your spirits up and your eyes on a brighter future. Keep going. If you feel like quitting, talk things over with a friend and your bookkeeper. Remember, two minds are better than one. Talking it over with trusted friends or professional financial people is a lot smarter than arguing with yourself or your partner.
- Play the *CASHFLOW*® tabletop game. One of the benefits of the *CASHFLOW* game that Kim and I developed, is that it gives your financial brain a workout. Whenever our minds are stuck with financial problems, and who doesn't have financial problems, we play the *CASHFLOW* game together. Not only do we learn something new, but the mental stimulation opens our minds up to new ways of solving our current problems.

I am not changing rich dad's advice. While he believed in expanding your means to be able to afford any lifestyle you want, there are times when you have to stop and take other measures to get started on the right track. Remember that old saying: "What do you do when you find yourself in a hole? Stop digging."

Earlier I referred to people who are at the red line of life. They are barely making it from paycheck to paycheck. The "Take Control of Your Cash Flow" formula from my book *Rich Dad's CASHFLOW Quadrant* and the following tips are designed to help you take those drastic steps that will help you "stop digging" and start a plan for a better financial future.

## *CASHFLOW Quadrant's Take Control of Your Cash Flow*

1. Review your financial statement that you just created.

2. Determine which quadrant of the CASHFLOW Quadrant you receive your income from today.

3. Determine which quadrant you want to receive the bulk of your income from in five years.

4. Begin your cash-flow management plan:

    - Pay yourself first. Put aside a set percentage from each paycheck or each payment you receive from other sources.

    - Deposit that money into an investment savings account. Once your money goes into the account, DO NOT take it out until you are ready to invest it.

    - Congratulate yourself! You have just started managing your cash flow.

    - Focus on reducing your personal debt.

## *Conclusion*

After I lost my first business, and found myself in the financial ruin I'd created, rich dad said to me, "When your car is broken, you take it to trained professional mechanics and they fix your car. The problem with your financial problems is that only one person can fix those problems, and that person is you." Explaining further, he said, "Your financial situation is much like your golf game. You can read books, attend seminars, hire a coach, and take lessons, but ultimately, only you can improve your golf game."

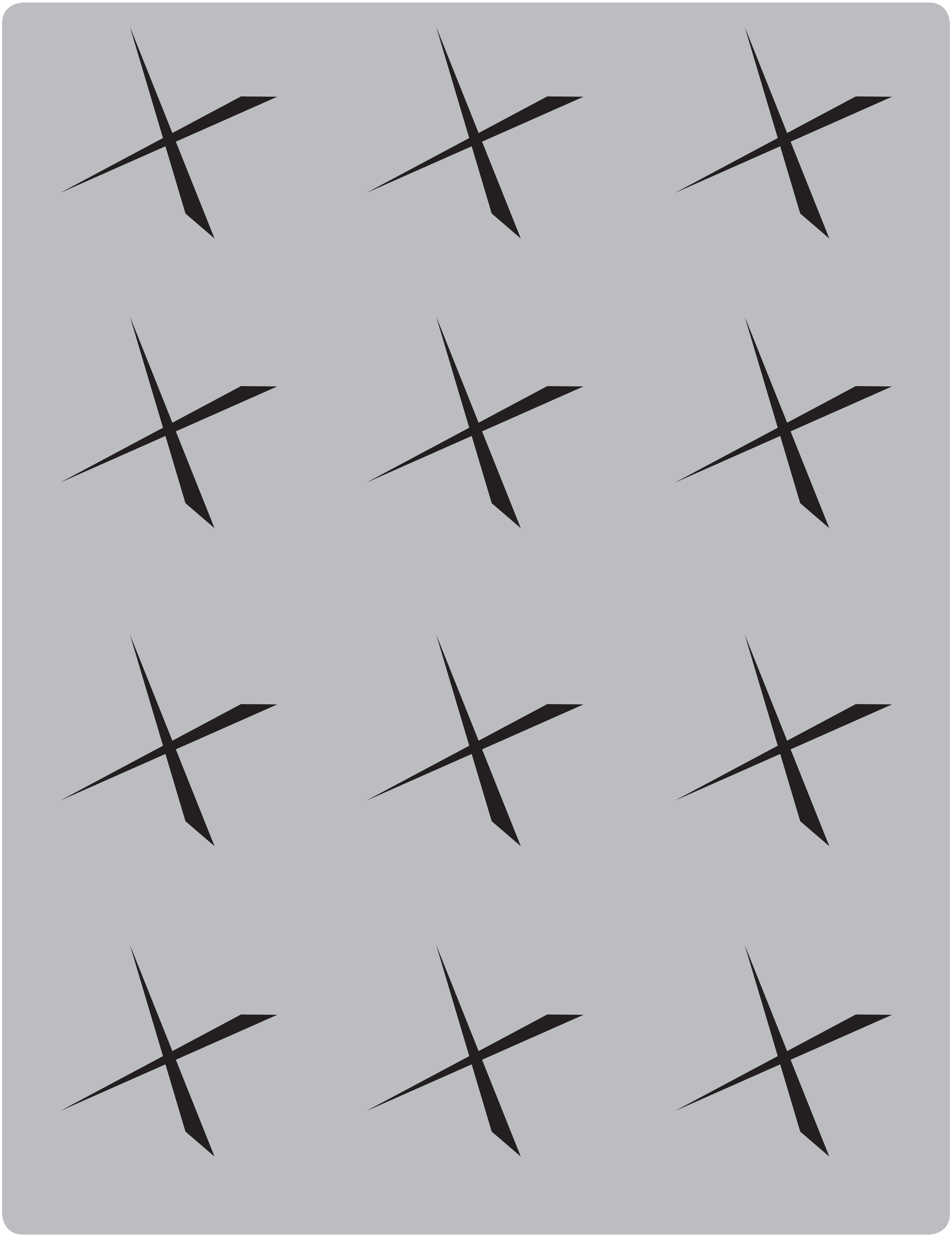
One of the reasons so few people attain great wealth is because, when people get into financial trouble, they do not know how to get out of trouble. No one has ever taught them the basics of how to diagnose the particular financial problem they may be in. As a result, although people may know they are in financial trouble, they do not know how to read a financial statement or how to keep accurate financial records, so they do not know how serious their financial problems are or how to fix them.

Facing my ruined financial statement was a painful experience. Yet facing my problems was the best thing I could have done. Rather than wasting time pretending I had no problems, I faced my financial statement and my problems and found out exactly what I did not know, as well as what I needed to learn in order to fix my financial situation.

Watching me groan and moan as I faced the financial train wreck, rich dad said, "If you are willing to face the truth and learn from your mistakes, you will learn far more about money than I could ever teach you." He went on to explain, saying, "When you face your own personal financial statement, you face yourself and your own financial challenges. You begin to find out what you know and what you do not know. When you look at your financial statement, you become accountable to yourself. Just as a golfer cannot blame anyone else for their bad scorecard, once you look at your accounting records, you become personally accountable."

Facing my financial problems and solving them was the best education I could have received because, by facing my mistakes, I became accountable for my own shortcomings. By facing my financial statement, I found out that I had failing financial grades. I realized that I was not as financially smart as I thought I was.

By improving those grades, I learned what I needed to learn in order to become financially free—and that is the price I paid.



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