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Leverage

Nathan and Josh Randall and Pat Nolan, the King of Leverage

LEVERAGE is one of the best words in the English language. I love this word. I see examples of leverage every day. My buddy Clay Conn and I always talk about leverage when we catch up. Clay is one of my few friends who actively looks for examples of leverage everywhere. I didn't understand leverage, what it meant, how to use it, and how it was used against me until I was about 35 years old. I read about how virtually every great fortune was made with leverage and without leverage you had to have a monumental moment happen or live to be 100 to gain a financial windfall.

Leverage in a tool form allows you to lift, carry, and remove more than you should be able to. Visualize a board with a pivot point lifting a huge boulder on the other end that you couldn't lift on your own. Here's that same image in a financial form. My favorite use of leverage is with real estate. I love that you can put a 20% down payment on a rental house and the bank puts up 80%. So your little 20% allowed you to pick up (obtain) this huge 100% ownership (or control) of a rental property. With leverage you get a house today verses waiting 10-15 or even 30 years to finally have saved enough money to pay cash for that rental house. The sad thing is that the house would typically cost you more now that you waited, like chasing a leaf in the wind.

Another way of thinking about it is this example. Let’s say you do have $100K and a rent house that you want to buy is $100K. So without leverage you buy one rent house with your $100K. No leverage but nice safe investment. Now apply leverage, the power to lift or do more than you can by taking that same $100K but using five chunks of $20K and buying 5- $100K houses. You own 20% of five houses and the bank owns 80%. Now fast forward 15 years and those $100K houses are now worth $200K each. In the non-leverage example, your one paid for house is worth $200K—a nice 100% increase; your $100K turned into $200K and you don't owe anyone anything. Now in the leveraged five house example, those five houses are worth $200K each or $1 million. You put $20K down on each of the houses with a starting mortgage of $80K.

Now 15 years later, let's say you owe $50K on each house; all the while your renters have been paying off your mortgage for you. Let's assume the renters have covered the mortgages plus a little profit. Let's tally up what the leveraged five house example is worth: you still owe the bank 5X$50K = $250K minus $1 million value. So with leverage you have $750K net value verses the non-leveraged $200K one house example – same time period but more than three times the value.

I thank my friend Pat Nolan (owner of Advantage Protection and 10 locations of Self Storage) for explaining leverage to me. Pat is a totally self-made guy who is married to Amy. Pat owned an alarm company and he and Amy used the equity in that business to borrow (leverage) and open their first self-storage business. They then continued to borrow against their current storage facility to build their next facilities. What Pat taught me was that if one house in a great area is good then 10 would be better! Pat asked questions like, "Do you think the U.S. dollar will be more or less valuable in the future?" I, of course, answered less valuable! Pat then replied then why in the world do you want to pay rentals properties off early with good "today dollars" when you could pay that mortgage off later with less valuable "tomorrow dollars?" You have more properties and more money because you aren't busy paying down on the few properties you have.

Pat also said he was amazed when he went to self-storage conventions, how many independent storage owners only had one facility. Pat said they would talk fondly of how their one facility was a great investment and they were glad they had that facility. I love how simply my friend Pat sees things. He makes business look easy by simply repeating and recreating things that work over and over again! Sure enough, Pat hit his goal of 10 facilities in 2015. He and Amy use the value of the other facilities to borrow money from the banks to build the next facility, so literally they are building additional sites without any extra dollars coming out of their pockets. Without Pat's insight and guidance I would have acquired rentals slowly. I would have maybe half the houses I have in the great city of Southlake. Finding affordable houses in that great school district is extremely hard, and now every good house comes with a bidding war. If an affordable house comes up for sale, it has 10 offers and is gone in a day. This may be bad for me as a buyer, but amazingly good for me as an eventual seller. Once I understood what Pat was doing. It gave me great confidence to go A LOT faster and use leverage to my financial advantage.

Throughout the process of rapidly acquiring rental properties, I would call my great friend and attorney Jim Zadeh. Jim is extremely level headed and a great sounding board. I would ask Jim if I was going too fast, he would ask me pointed questions, and we came to the conclusion that I wasn't going too fast. I mentioned earlier that I see leverage everywhere, in relationships, business dominance, etc. An example of business leverage would be Walmart over the manufacturers of products that they sell. Let's say you make straws to drink soda with, and you sell through Walmart. Walmart can sell a zillion of your straws, so you are forced to acknowledge their dominance and give them the best price best terms and best delivery.

Walmart owns all the leverage or advantage in the relationship because there are 25 other straw manufactures that would love to be in your shoes. You are forced to acknowledge that if you lose Walmart business there isn't anywhere to make it up. I have a saying that I use weekly, if not daily. "The person bitching doesn't have the leverage." What I mean by that is if someone is complaining about something I bet there's 99% chance that person doesn't have the leverage or upper hand in the relationship or scenario.

For example, you complain that yet again the price of a stamp has gone up! Post office holds all the leverage because no one is going to deliver anything 2000 miles away for only 53 cents, so bitch all you want they hold all the cards. With my business and rental properties I don't abuse the position, I hold with leverage but I sure do enjoy being on the lever side more than de-lever side. There's an old saying that goes: the real golden rule is the one with the gold makes the rules. The same could be said with leverage, "the one with the leverage makes the rules."

15 Years Later

January 1st, 2032

NO LEVERAGE

$100K HOUSE

YOU OWN 100%

NOW WORTH
$200K
YOU MADE
$100K

LEVERAGE

HOUSE #1

$20K DOWN
$50K LOAN
100% CONTROL
WORTH $200K
$150K EQUITY

HOUSE #2

$20K DOWN
$50K LOAN
100% CONTROL
WORTH $200K
$150K EQUITY

HOUSE #3

$20K DOWN
$50K LOAN
100% CONTROL
WORTH $200K
$150K EQUITY

HOUSE #4

$20K DOWN
$50K LOAN
100% CONTROL
WORTH $200K
$150K EQUITY

HOUSE #5

$20K DOWN
$50K LOAN
100% CONTROL
WORTH $200K
$150K EQUITY

$ 1 MILLION VALUE
YOU OWE $250K
YOU MADE
5 x $150K = $750K