

Maximize Return by Using Leverage

What is Leverage? It is an effective investment strategy of using borrowed money to generate higher investment returns. When you actually stop to look at the everyday real estate transactions, a home purchase with only 10 - 25% down payment is actually using leverage!



How to maximize Leverage: Using leverage in real estate investing is a great way to earn big yields on small investment. When you are building real estate wealth, leverage will help you grow quickly without involving too much risk (as long as you watch out for some pitfalls, which will be discussed later). High leveraged investing in real estate is especially powerful when inflation is in full swing. High leverage investors have numbers going for them because property values rise faster than the interest charges on their borrowed money.

Example: For example, with a \$100,000 investment (10% down payment) an investor can acquire a property worth as much as \$1,000,000. The buyer is essentially using a relatively small percentage of his or her own money to make the purchase, and the majority of the money is being provided by a lender. Assuming the property appreciates at 5% per year, the borrower's net worth from this purchase would grow by \$50,000 in just 12 months. ($5\% \times \$1,000,000$). It is the capital appreciation of the asset that brings wealth. In other words, the 100,000 investment produced a return of \$50,000! A whopping 50% return.

Now let's suppose the investor bought the same million dollar property with a 25% down payment (\$250,000), and let's assume the interest rate on the mortgage was at 4% per annum. The difference in the interest saved with this strategy would have been \$6,000.00 ($\$150,000 \times 4\%$), therefore the net return was \$56,000.00 (appreciation of \$50,000 + \$6,000 interest saved). However with the higher down payment, the return on investment in this scenario would have been only 23%. ($\$56,000 / \$250,000$). A huge difference in the rate of return than from the first scenario.

Now you can clearly see how Leverage can bring higher returns! And that is not all! With a long term hold you will benefit from, the mortgage reduction, positive cash flow and most importantly the increase in property value.

The Risk: To a lot of people, leverage means risk. The reason is that with leverage you may run the risk of unexpected negative cash flow that could risk the investment. To reduce that risk:

- Assure the income generated from the property is able to support the operating expenses and all the carrying costs.
- Be aware and always be ready for any unforeseen capital expenditures or sudden increase in interest rates, which may tremendously impact the property cash flow. Always have extra cash available when needed. Therefore when you buy using high leverage, remember to leave yourself a healthy cash reserve for the unexpected.

Summary: As we've demonstrated that using Leverage in Real Estate offers a number of advantages you simply cannot achieve in other investment vehicles.

This explains in part why most wealthy individuals have either made or now hold the majority of their wealth in Real Estate. It is my sincere belief that when you compare the returns, risks and barriers to success, Real Estate

should be a component of every successful investor's portfolio, and using Leverage will maximize return.



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