BUS-123 Spring 2013 Real Estate & Leverage Name: KEY
Instr: F. Paiano Worksheet

1. *Calculating the Return on Investment without using Financial Leverage.* Dave bought a rental property for $200,000 cash. One year later, he sold it for $240,000. What was the return on his $200,000 investment?

Sold $240 000
bought −200 000
$40 000 gain

$40 000 gain / $200 000 investment = 0.20 20% return on investment

2. *Calculating the Return on Investment using Financial Leverage.* Suppose Dave invested only $20,000 of his own money and borrowed $180,000 (90% financing). What was the return on his investment?

Sold $240000
bought −200000
$40 000 gain

borrowed $180000
invested $20000

$40000 / $20000 = 2.00 200% return on investment

666. *Calculating the Return on Investment using Financial Leverage and things do not go as planned.* Suppose Dave invested only $20,000 of his own money and borrowed $180,000 (90% financing) … and the property value went down 20%. Now, the question is, *"What is he going to tell his wife?"*

bought $200000
worth only $160000

But still owes $180000
He lost all $20000 initial investment.

"Honey, we have a problem!"
His investment is "under water."
He owes more than it is worth.