

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?

$$\begin{array}{r} \text{Sold } \$240,000 \\ \text{bought } -200,000 \\ \hline \$40,000 \text{ gain} \end{array} \quad \frac{\$40,000 \text{ gain}}{\$200,000 \text{ investment}} = 0.20 \quad \underline{20\%} \text{ return on investment}$$

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?

$$\begin{array}{r} \text{Sold } \$240,000 \\ \text{bought } -200,000 \\ \hline \$40,000 \text{ gain} \end{array} \quad \begin{array}{r} \text{borrowed } \$180,000 \\ \text{invested } \$20,000 \end{array} \quad \frac{\$40,000}{\$20,000} = 2.00 \quad \underline{200\%} \text{ return on investment}$$

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 \$20,000  
worth only \$16,000

But still owes \$180,000  
He lost all \$20,000 initial investment.

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