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Understanding Leverage: When It Helps — and When It Hurts

How debt can enhance returns — and where it introduces risk

Leverage is one of the defining features of real estate investing.

By using debt to acquire and operate assets, investors are able to control larger properties with less equity, potentially enhancing returns.

At the same time, leverage introduces risk.

Understanding how and when leverage works — and where it can create pressure — is an important part of evaluating any real estate investment.

How Leverage Works

At its core, leverage involves using borrowed capital to finance a portion of an investment.

Rather than purchasing a property entirely with equity, investors contribute a portion of the capital while the remainder is funded through debt.

If the investment performs well, leverage can amplify returns by allowing investors to benefit from the performance of the entire asset while only investing a portion of the total capital.

This dynamic is one of the reasons real estate has historically been an effective asset class for generating returns.

When Leverage Enhances Returns

Leverage tends to be most effective when:

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- The property generates stable cash flow
- The cost of debt is predictable
- The business plan is achievable and well-defined

In these cases, debt can act as a tool to improve capital efficiency.

For example, if a property produces consistent income and financing costs are controlled, leverage allows investors to earn returns on both their invested capital and the borrowed capital supporting the asset.

When combined with disciplined execution, this can enhance overall performance without significantly increasing risk.

Where Leverage Introduces Risk

While leverage can improve returns, it also creates fixed obligations.

Debt must be serviced regardless of how the property performs.

This introduces several potential risks:

- **Reduced margin for error**
Higher leverage leaves less room for variability in income or expenses
- **Exposure to market conditions**
Changes in interest rates or financing availability can impact performance
- **Refinancing risk**
Future loan terms may differ from initial assumptions
- **Liquidity pressure**
If performance declines, debt obligations can limit flexibility

In these situations, leverage can amplify downside outcomes as easily as it enhances upside.

The Role of Debt Structure



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Not all leverage is the same.

The structure of the debt can have a significant impact on risk.

Key considerations include:

- **Fixed vs. floating interest rates**
Fixed-rate debt provides stability and predictability, while floating-rate debt introduces exposure to changes in interest rates
- **Loan term and maturity**
Shorter-term debt may require refinancing sooner, increasing exposure to market conditions
- **Amortization and interest-only periods**
These affect both cash flow and long-term equity build-up

A well-structured loan can help mitigate risk, while a poorly structured one can introduce additional volatility.

Balancing Leverage and Stability

The objective is not to avoid leverage entirely, but to use it in a way that supports the underlying investment.

This typically involves:

- Maintaining a conservative level of debt relative to the asset
- Aligning financing with the business plan
- Ensuring that the property can comfortably support debt service

In practice, this means prioritizing stability over maximizing leverage.

While higher leverage can increase projected returns, it also reduces flexibility and increases sensitivity to changes in performance.

How We Think About It

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We view leverage as a tool — one that should support the investment rather than define it.

Our approach emphasizes:

- Conservative leverage levels
- Fixed-rate financing where possible
- Business plans that do not rely on favorable debt assumptions

The starting point remains the asset itself.

If the underlying fundamentals are strong — supported by stable cash flow and durable demand — leverage can enhance returns in a controlled way.

If those fundamentals are not in place, leverage can introduce unnecessary risk.

Final Considerations

Leverage is neither inherently good nor bad. Its impact depends on how it is used.

For investors, the key is understanding how debt interacts with the underlying investment — and how it affects both potential returns and downside risk.

In many cases, the difference between a resilient investment and a fragile one is not the projected return, but the level and structure of leverage supporting it.