



Investing in Real Estate, Rule of 72

If real estate prices increase at the same pace as inflation (aprox 3%), then leveraging a property is sure to make you money in the long run.

Rule of 72: A rule stating that in order to find the number of years required to double your money at a given interest rate, you divide the compound return into 72. The result is the approximate number of years that it will take for your investment to double.

[Rule of 72](#) (Investopedia.com)

So, if we divide 72 by the rate of inflation (3%), we get 24 or ($72 \div 3 = 24$).

Formula: $72 \div \% = \text{Years}$

72 (the rule) divided by x% (rate of return) = the number of years for value to double

This means that a house will double in value in (aprox) 24 years due to inflation alone. I know this doesn't sound too enticing but when we leverage, it changes everything.

If you buy a house for \$100,000 and put down 25% with a 75% mortgage (leveraging) our rate of return changes drastically. In 24 years your house will be worth \$200,000 but the return on the investment will be 4 times your initial investment of \$25,000 (or \$100,000).

Since the return will be 4 times greater, we then divide the 24 years by 4 to see that our investment will actually double in just 6 years ($24 \div 4 = 6$). Going back to Rule 72, we divide 72 by the number of years and you'll see that our rate of return will be 12% ($72 \div 6 = 12$).

By leveraging, at inflation levels alone, we get 12% returns.

If you're not impressed with a 12% return, think about the rate of return you get from your bank (much lower I'm sure).

What if real estate increases at a higher rate than inflation? Let's take a conservative number like 7.2% (it works well with Rule 72 and I believe it is fairly close to historical rates). This will cause real estate to double in 10 years which will give you a rate of return (based on same percentages as above) of 400% (or 25% annually) on your initial investment.

Use Rule of 72 to calculate returns on potential investment property. Keep in mind that when a property doubles in value (aprox 10 years), it is the entire property that has doubled (not just your cash investment). So if your down payment is only 10% with a 7.2% annual increase in real estate? Your return would be 100% per year on your initial investment.

You think this can't happen? What would you think if I told you that I bought an investment property at the height of the real estate market (November of 2005) and my returns have been 100% annually on my initial investment for the first 2 years (with a 25% down)?

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