

Illustration of the **Four Components of "Return on Investment"**

1 **Cash Flow**

This first and perhaps most obvious component is "cash flow" - rental income minus expenses - or how much cash ends up in your pocket.

81,639	+	Rental Income
35,799	-	Operating Expenses
32,516	-	Mortgage Payments
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13,323	=	Cash Flow
195,000	/	Downpayment + Closing Costs
6.8%	=	Return on Investment from Cash Flow

2 **Appreciation**

As the value of the property increases, your return on investment increases.

650,000	=	Acquisition Price
5%	*	First Year Appreciation
682,500	=	Value at the end of Year 1.
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32,500	=	Amount of Value Increase
195,000	/	Downpayment + Closing Costs
17%	=	Return on Investment from Appreciation

3 **Equity Build-Up**

4.50% 25 \$ 2,709.68

Even if the property did not increase in value, Equity will increase solely from paying down the mortgage.

487,500	=	Loan Amount at Closing
476,700	=	Loan Amount at the end of Year 1
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10,800	-	Equity Build-Up in Year 1
195,000	/	Downpayment + Closing Costs
5.5%	=	Return on Investment from Equity Build-Up

4 **Tax Benefits**

One pays less income taxes on a real estate investment than on other investment vehicles.

45,839	=	Cash Flow Before Loan Payments (rents less expenses)
20,091	-	Depreciation (assumes 15% land, 27.5 year recovery)
21,717	-	Mortgage Interest
4,032	=	Taxable Income Year 1
33%	*	Marginal Tax Rate
1,330	=	Federal Income Tax
1,330		Federal Income Tax
13,323	/	Cash Flow
10.0%	=	Effective Tax Rate on This Investment
4,397	=	Tax if Cash Flow came from a non-preferred investment vehicle
1,330	-	Tax from this preferred investment vehicle.
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3,066	=	Income Tax Savings
1.6%		Return on Investment from Tax Savings

Total / Summary

1:	13,323	Cash Flow
2:	32,500	Appreciation Year 1
3:	10,800	Equity Build Up Year 1
4:	3,066	Tax Savings Year 1
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	59,689	Total Return from this Investment
	195,000	Downpayment + Closing Costs
	30.6%	Total Return from this Investment

**Illustration of Internal Rate of Return over a 10-Year Holding Period
1422 PARK AVENUE**

Purchase Price	650,000	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Annual Rent	4.0%	84,164	87,530	91,031	94,673	98,459	102,398	106,494	110,753	115,184	119,791
Vacancy	3.0%	2,525	2,626	2,731	2,840	2,954	3,072	3,195	3,323	3,456	3,594
Effective Income		81,639	84,904	88,300	91,832	95,506	99,326	103,299	107,431	111,728	116,197
Expenses	4.0%	35,799	37,231	38,721	40,269	41,880	43,555	45,298	47,109	48,994	50,954
Exp as a percent of Annual Rent		44%	44%	44%	44%	44%	44%	44%	44%	44%	44%
Exp per unit	6	5,967	6,205	6,453	6,712	6,980	7,259	7,550	7,852	8,166	8,492
NOI	0	45,839	47,673	49,580	51,563	53,625	55,770	58,001	60,321	62,734	65,244
Debt Service	\$ 2,710	32,516	32,516	32,516	32,516	32,516	32,516	32,516	32,516	32,516	32,516
Before Tax Cash Flow	(195,000)	13,323	15,157	17,064	19,047	21,109	23,254	25,485	27,805	30,218	548,161
17.4% Internal Rate of Return											
NOI		45,839	47,673	49,580	51,563	53,625	55,770	58,001	60,321	62,734	65,244
Less Interest		21,717	21,220	20,702	20,159	19,591	18,997	18,376	17,727	17,047	16,337
Less Depreciation		18,909	18,909	18,909	18,909	18,909	18,909	18,909	18,909	18,909	18,909
Taxable Income	0	5,214	7,543	9,969	12,495	15,125	17,864	20,716	23,686	26,778	29,998
Tax @	25%	1,303	1,886	2,492	3,124	3,781	4,466	5,179	5,921	6,694	7,499
After Tax Cash Flow	(195,000)	12,020	13,271	14,571	15,923	17,328	18,788	20,306	21,884	23,524	458,914
14.7% Internal Rate of Return											
Purchase	650,000							Assume a Sale at End of Year 10			
L-V	75%							Annual Rent Roll			119,791
Loan	487,500							GRM			7.7
Down Payment	162,500						annual appreciation	3.6%	Price		925,153
Cap Improvement	-								Sale Costs	6%	55,509
Closing Costs	32,500								Less: Basis		460,909
Initial Investment	195,000								Gain		408,734
Rate	4.50%								Tax @	20%	81,747
Term	25								Mortgage Balance		354,210
P&I	\$2,709.68								Sale Proceeds Before Tax		515,433
									Sale Proceeds After Tax		433,687
Mortgage Amortization		1	2	3	4	5	6	7	8	9	10
487,500	Beg Bal	487,500	476,700	465,405	453,590	441,232	428,307	414,788	400,648	385,859	370,390
4.50%	Prin	10,800	11,296	11,815	12,357	12,925	13,519	14,140	14,790	15,469	16,180
25.0	Int	21,717	21,220	20,702	20,159	19,591	18,997	18,376	17,727	17,047	16,337
2,710	Bal EOY	476,700	465,405	453,590	441,232	428,307	414,788	400,648	385,859	370,390	354,210
Cost Recovery / Depreciation		650,000	650,000	Building	80%	520,000	Land	20%	130,000	Life	27.5
		18,909	18,909	18,909	18,909	18,909	18,909	18,909	18,909	18,909	18,909
Basis		631,091	612,182	593,273	574,364	555,455	536,545	517,636	498,727	479,818	460,909