

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.

67,860	+	Rental Income
21,069	-	Operating Expenses
33,154	-	Mortgage Payments
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13,637	=	Cash Flow
204,000	/	Downpayment + Closing Costs
6.7%	=	Return on Investment from Cash Flow

2 **Appreciation**

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

680,000	=	Acquisition Price
5%	*	First Year Appreciation
714,000	=	Value at the end of Year 1.
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34,000	=	Amount of Value Increase
204,000	/	Downpayment + Closing Costs
17%	=	Return on Investment from Appreciation

3 **Equity Build-Up**

4.25% 25 \$ 2,762.86

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

510,000	=	Loan Amount at Closing
498,294	=	Loan Amount at the end of Year 1
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11,706	-	Equity Build-Up in Year 1
204,000	/	Downpayment + Closing Costs
5.7%	=	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.

46,791	=	Cash Flow Before Loan Payments (rents less expenses)
21,018	-	Depreciation (assumes 15% land, 27.5 year recovery)
21,449	-	Mortgage Interest
4,324	=	Taxable Income Year 1
33%	*	Marginal Tax Rate
1,427	=	Federal Income Tax
1,427		Federal Income Tax
13,637	/	Cash Flow
10.5%	=	Effective Tax Rate on This Investment
4,500	=	Tax if Cash Flow came from a non-preferred investment vehicle
1,427	-	Tax from this preferred investment vehicle.
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3,073	=	Income Tax Savings
1.5%		Return on Investment from Tax Savings

Total / Summary

1:	13,637	Cash Flow
2:	34,000	Appreciation Year 1
3:	11,706	Equity Build Up Year 1
4:	3,073	Tax Savings Year 1
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	62,416	Total Return from this Investment
	204,000	Downpayment + Closing Costs
	30.6%	Total Return from this Investment

**Illustration of Internal Rate of Return over a 10-Year Holding Period
722 GLADSTONE AVENUE**

Purchase Price	680,000	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Annual Rent	4.0%	67,860	70,574	73,397	76,333	79,387	82,562	85,865	89,299	92,871	96,586
Vacancy	3.0%	2,036	2,117	2,202	2,290	2,382	2,477	2,576	2,679	2,786	2,898
Effective Income		65,824	68,457	71,195	74,043	77,005	80,085	83,289	86,620	90,085	93,688
Expenses	4.0%	21,069	21,912	22,788	23,700	24,648	25,634	26,659	27,725	28,834	29,988
Exp as a percent of Annual Rent		32%	32%	32%	32%	32%	32%	32%	32%	32%	32%
Exp per unit	6	3,511	3,652	3,798	3,950	4,108	4,272	4,443	4,621	4,806	4,998
NOI	0	44,755	46,546	48,407	50,344	52,357	54,452	56,630	58,895	61,251	63,701
Debt Service	\$ 2,763	33,154	33,154	33,154	33,154	33,154	33,154	33,154	33,154	33,154	33,154
Before Tax Cash Flow	(204,000)	11,601	13,391	15,253	17,189	19,203	21,297	23,475	25,741	28,096	573,061
16.5% Internal Rate of Return											
NOI		44,755	46,546	48,407	50,344	52,357	54,452	56,630	58,895	61,251	63,701
Less Interest		21,449	20,941	20,412	19,860	19,284	18,683	18,055	17,401	16,718	16,006
Less Depreciation		19,782	19,782	19,782	19,782	19,782	19,782	19,782	19,782	19,782	19,782
Taxable Income	0	3,525	5,822	8,213	10,702	13,292	15,987	18,792	21,712	24,750	27,913
Tax @	25%	881	1,456	2,053	2,675	3,323	3,997	4,698	5,428	6,188	6,978
After Tax Cash Flow	(204,000)	10,720	11,936	13,200	14,514	15,880	17,301	18,777	20,313	21,909	480,563
13.9% Internal Rate of Return											
Purchase	680,000								Assume a Sale at End of Year 10		
L-V	75%								Annual Rent Roll		96,586
Loan	510,000								GRM		10.0
Down Payment	170,000						annual appreciation	3.6%	Price		967,852
Cap Improvement	-								Sale Costs	6%	58,071
Closing Costs	34,000								Less: Basis		482,182
Initial Investment	204,000								Gain		427,599
Rate	4.25%								Tax @	20%	85,520
Term	25								Mortgage Balance		367,266
P&I	\$2,762.86								Sale Proceeds Before Tax		542,515
									Sale Proceeds After Tax		456,995
Mortgage Amortization		1	2	3	4	5	6	7	8	9	10
510,000 Beg Bal		510,000	498,294	486,081	473,339	460,045	446,174	431,702	416,604	400,850	384,414
4.25% Prin		11,706	12,213	12,742	13,294	13,871	14,472	15,099	15,753	16,436	17,148
25.0 Int		21,449	20,941	20,412	19,860	19,284	18,683	18,055	17,401	16,718	16,006
2,763 Bal EOY		498,294	486,081	473,339	460,045	446,174	431,702	416,604	400,850	384,414	367,266
Cost Recovery / Depreciation		680,000	680,000	Building	80%	544,000	Land	20%	136,000	Life	27.5
		19,782	19,782	19,782	19,782	19,782	19,782	19,782	19,782	19,782	19,782
Basis		660,218	640,436	620,655	600,873	581,091	561,309	541,527	521,745	501,964	482,182