

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.

35,400	+	Rental Income
12,093	-	Operating Expenses
15,203	-	Mortgage Payments
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8,104	=	Cash Flow
73,750	/	Downpayment + Closing Costs
11.0%	=	Return on Investment from Cash Flow

2 **Appreciation**

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

295,000	=	Acquisition Price
5%	*	First Year Appreciation
309,750	=	Value at the end of Year 1.
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14,750	=	Amount of Value Increase
73,750	/	Downpayment + Closing Costs
20%	=	Return on Investment from Appreciation

3 **Equity Build-Up**

5.00% 30 \$ 1,266.90

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

236,000	=	Loan Amount at Closing
232,518	=	Loan Amount at the end of Year 1
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3,482	-	Equity Build-Up in Year 1
73,750	/	Downpayment + Closing Costs
4.7%	=	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.

23,307	=	Cash Flow Before Loan Payments (rents less expenses)
9,118	-	Depreciation (assumes 15% land, 27.5 year recovery)
11,721	-	Mortgage Interest
2,468	=	Taxable Income Year 1
33%	*	Marginal Tax Rate
814	=	Federal Income Tax
814		Federal Income Tax
8,104	/	Cash Flow
10.0%	=	Effective Tax Rate on This Investment
2,674	=	Tax if Cash Flow came from a non-preferred investment vehicle
814	-	Tax from this preferred investment vehicle.
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1,860	=	Income Tax Savings
2.5%	=	Return on Investment from Tax Savings

Total / Summary

1:	8,104	Cash Flow
2:	14,750	Appreciation Year 1
3:	3,482	Equity Build Up Year 1
4:	1,860	Tax Savings Year 1
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	28,196	Total Return from this Investment
	73,750	Downpayment + Closing Costs
	38.2%	Total Return from this Investment

Illustration of Internal Rate of Return over a 10-Year Holding Period

6049 FALLS ROAD

Purchase Price	295,000	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Annual Rent	4.0%	35,400	36,816	38,289	39,820	41,413	43,070	44,792	46,584	48,447	50,385
Expenses	4.0%	12,093	12,577	13,080	13,603	14,147	14,713	15,302	15,914	16,550	17,212
Exp as a percent of Annual Rent		34%	34%	34%	34%	34%	34%	34%	34%	34%	34%
Exp per unit	3	4,031	4,192	4,360	4,534	4,716	4,904	5,101	5,305	5,517	5,737
NOI	0	23,307	24,239	25,209	26,217	27,266	28,357	29,491	30,670	31,897	33,173
Debt Service	\$ 1,267	15,203	15,203	15,203	15,203	15,203	15,203	15,203	15,203	15,203	15,203
Before Tax Cash Flow	(73,750)	8,104	9,036	10,006	11,014	12,063	13,154	14,288	15,468	16,694	220,687
21.4% Internal Rate of Return											
NOI		23,307	24,239	25,209	26,217	27,266	28,357	29,491	30,670	31,897	33,173
Less Interest		11,721	11,543	11,356	11,159	10,952	10,734	10,506	10,265	10,013	9,747
Less Depreciation		8,582	8,582	8,582	8,582	8,582	8,582	8,582	8,582	8,582	8,582
Taxable Income	0	3,004	4,115	5,271	6,477	7,732	9,040	10,403	11,823	13,303	14,844
Tax @	25%	751	1,029	1,318	1,619	1,933	2,260	2,601	2,956	3,326	3,711
After Tax Cash Flow	(73,750)	7,353	8,008	8,688	9,395	10,130	10,894	11,687	12,512	13,369	179,876
18.3% Internal Rate of Return											
Purchase	295,000								Assume a Sale at End of Year 10		
L-V	80%								Annual Rent Roll		50,385
Loan	236,000								GRM		8.3
Down Payment	59,000							annual appreciation	3.6%	Price	419,877
Cap Improvement	-									Sale Costs	6% 25,193
Closing Costs	14,750									Less: Basis	209,182
Initial Investment	73,750									Gain	185,503
Rate	5.00%									Tax @	20% 37,101
Term	30									Mortgage Balance	191,967
P&I	\$1,266.90									Sale Proceeds Before Tax	202,717
										Sale Proceeds After Tax	165,617
Mortgage Amortization		1	2	3	4	5	6	7	8	9	10
236,000	Beg Bal	236,000	232,518	228,858	225,011	220,967	216,716	212,247	207,550	202,613	197,423
5.00%	Prin	3,482	3,660	3,847	4,044	4,251	4,468	4,697	4,937	5,190	5,456
30.0	Int	11,721	11,543	11,356	11,159	10,952	10,734	10,506	10,265	10,013	9,747
1,267	Bal EOY	232,518	228,858	225,011	220,967	216,716	212,247	207,550	202,613	197,423	191,967
Cost Recovery / Depreciation		295,000	295,000	Building	80%	236,000	Land	20%	59,000	Life	27.5
		8,582	8,582	8,582	8,582	8,582	8,582	8,582	8,582	8,582	8,582
Basis		286,418	277,836	269,255	260,673	252,091	243,509	234,927	226,345	217,764	209,182