

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.

33,900	+	Rental Income
11,963	-	Operating Expenses
12,768	-	Mortgage Payments
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9,168	=	Cash Flow
84,000	/	Downpayment + Closing Costs
10.9%	=	Return on Investment from Cash Flow

2 **Appreciation**

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

280,000	=	Acquisition Price
5%	*	First Year Appreciation
294,000	=	Value at the end of Year 1.
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14,000	=	Amount of Value Increase
84,000	/	Downpayment + Closing Costs
17%	=	Return on Investment from Appreciation

3 **Equity Build-Up**

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

210,000	=	Loan Amount at Closing
206,612	=	Loan Amount at the end of Year 1
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3,388	-	Equity Build-Up in Year 1
84,000	/	Downpayment + Closing Costs
4.0%	=	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.

21,937	=	Cash Flow Before Loan Payments (rents less expenses)
8,655	-	Depreciation (assumes 15% land, 27.5 year recovery)
9,381	-	Mortgage Interest
3,902	=	Taxable Income Year 1
33%	*	Marginal Tax Rate
1,288	=	Federal Income Tax
1,288		Federal Income Tax
9,168	/	Cash Flow
14.0%	=	Effective Tax Rate on This Investment
3,026	=	Tax if Cash Flow came from a non-preferred investment vehicle
1,288	-	Tax from this preferred investment vehicle.
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1,738	=	Income Tax Savings
2.1%		Return on Investment from Tax Savings

Total / Summary

1:	9,168	Cash Flow
2:	14,000	Appreciation Year 1
3:	3,388	Equity Build Up Year 1
4:	1,738	Tax Savings Year 1
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	28,294	Total Return from this Investment
	84,000	Downpayment + Closing Costs
	33.7%	Total Return from this Investment

Illustration of Internal Rate of Return over a 10-Year Holding Period
8 3 2 1/2 WEST LOMBARD STREET

Purchase Price	280,000	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Annual Rent	4.0%	33,900	35,256	36,666	38,133	39,658	41,245	42,894	44,610	46,394	48,250
Expenses	4.0%	11,963	12,442	12,939	13,457	13,995	14,555	15,137	15,743	16,372	17,027
Exp as a percent of Annual Rent		35%	35%	35%	35%	35%	35%	35%	35%	35%	35%
Exp per unit	3	3,988	4,147	4,313	4,486	4,665	4,852	5,046	5,248	5,457	5,676
NOI	0	21,937	22,814	23,727	24,676	25,663	26,689	27,757	28,867	30,022	31,223
Debt Service	\$ 1,064	12,768	12,768	12,768	12,768	12,768	12,768	12,768	12,768	12,768	12,768
Before Tax Cash Flow	(84,000)	9,168	10,046	10,958	11,907	12,894	13,921	14,989	16,099	17,254	4,345,655
52.5% Internal Rate of Return											
NOI		21,937	22,814	23,727	24,676	25,663	26,689	27,757	28,867	30,022	31,223
Less Interest		9,381	9,225	9,062	8,892	8,714	8,528	8,333	8,129	7,916	7,693
Less Depreciation		8,145	8,145	8,145	8,145	8,145	8,145	8,145	8,145	8,145	8,145
Taxable Income	0	4,411	5,444	6,519	7,638	8,804	10,016	11,279	12,593	13,961	15,384
Tax @	25%	1,103	1,361	1,630	1,910	2,201	2,504	2,820	3,148	3,490	3,846
After Tax Cash Flow	(84,000)	8,066	8,685	9,329	9,998	10,694	11,417	12,169	12,951	13,763	3,482,440
48.8% Internal Rate of Return											
Purchase	280,000								Assume a Sale at End of Year 10		
L-V	75%								Annual Rent Roll		48,250
Loan	210,000								GRM		99.1
Down Payment	70,000				annual appreciation	32.8%			Price		4,782,328
Cap Improvement	-								Sale Costs	6%	286,940
Closing Costs	14,000								Less: Basis		198,545
Initial Investment	84,000								Gain		4,296,843
Rate	4.50%								Tax @	20%	859,369
Term	30								Mortgage Balance		168,188
P&I	\$1,064.04								Sale Proceeds Before Tax		4,327,200
									Sale Proceeds After Tax		3,467,832
Mortgage Amortization		1	2	3	4	5	6	7	8	9	10
210,000	Beg Bal	210,000	206,612	203,069	199,363	195,486	191,432	187,191	182,755	178,116	173,263
4.50%	Prin	3,388	3,543	3,706	3,876	4,055	4,241	4,436	4,639	4,853	5,075
30.0	Int	9,381	9,225	9,062	8,892	8,714	8,528	8,333	8,129	7,916	7,693
1,064	Bal EOY	206,612	203,069	199,363	195,486	191,432	187,191	182,755	178,116	173,263	168,188
Cost Recovery / Depreciation		280,000	280,000	Building	80%	224,000	Land	20%	56,000	Life	27.5
		8,145	8,145	8,145	8,145	8,145	8,145	8,145	8,145	8,145	8,145
Basis		271,855	263,709	255,564	247,418	239,273	231,127	222,982	214,836	206,691	198,545