

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.

57,570	+	Rental Income
17,955	-	Operating Expenses
24,202	-	Mortgage Payments
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15,413	=	Cash Flow
138,000	/	Downpayment + Closing Costs
11.2%	=	Return on Investment from Cash Flow

2 **Appreciation**

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

460,000	=	Acquisition Price
5%	*	First Year Appreciation
483,000	=	Value at the end of Year 1.
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23,000	=	Amount of Value Increase
138,000	/	Downpayment + Closing Costs
17%	=	Return on Investment from Appreciation

3 **Equity Build-Up**

5.00% 25 \$ 2,016.84

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

345,000	=	Loan Amount at Closing
337,886	=	Loan Amount at the end of Year 1
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7,114	-	Equity Build-Up in Year 1
138,000	/	Downpayment + Closing Costs
5.2%	=	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.

39,615	=	Cash Flow Before Loan Payments (rents less expenses)
14,218	-	Depreciation (assumes 15% land, 27.5 year recovery)
17,088	-	Mortgage Interest
8,308	=	Taxable Income Year 1
33%	*	Marginal Tax Rate
2,742	=	Federal Income Tax
2,742		Federal Income Tax
15,413	/	Cash Flow
17.8%	=	Effective Tax Rate on This Investment
5,086	=	Tax if Cash Flow came from a non-preferred investment vehicle
2,742	-	Tax from this preferred investment vehicle.
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2,345	=	Income Tax Savings
1.7%		Return on Investment from Tax Savings

Total / Summary

1:	15,413	Cash Flow
2:	23,000	Appreciation Year 1
3:	7,114	Equity Build Up Year 1
4:	2,345	Tax Savings Year 1
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	47,871	Total Return from this Investment
	138,000	Downpayment + Closing Costs
	34.7%	Total Return from this Investment

**Illustration of Internal Rate of Return over a 10-Year Holding Period
2904 GUILFORD AVENUE**

Purchase Price	460,000	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Annual Rent	4.0%	60,600	63,024	65,545	68,167	70,893	73,729	76,678	79,745	82,935	86,253
Vacancy	3.0%	1,818	1,891	1,966	2,045	2,127	2,212	2,300	2,392	2,488	2,588
Effective Income		58,782	61,133	63,579	66,122	68,767	71,517	74,378	77,353	80,447	83,665
Expenses	4.0%	17,955	18,673	19,420	20,197	21,005	21,845	22,719	23,628	24,573	25,556
Exp as a percent of Annual Rent		31%	31%	31%	31%	31%	31%	31%	31%	31%	31%
Exp per unit	5	3,591	3,735	3,884	4,039	4,201	4,369	4,544	4,726	4,915	5,111
NOI	0	40,827	42,460	44,158	45,925	47,762	49,672	51,659	53,725	55,874	58,109
Debt Service	\$ 2,017	24,202	24,202	24,202	24,202	24,202	24,202	24,202	24,202	24,202	24,202
Before Tax Cash Flow	(138,000)	16,625	18,258	19,956	21,723	23,560	25,470	27,457	29,523	31,672	394,308
21.6% Internal Rate of Return											
NOI		40,827	42,460	44,158	45,925	47,762	49,672	51,659	53,725	55,874	58,109
Less Interest		17,088	16,725	16,342	15,940	15,517	15,073	14,606	14,115	13,599	13,056
Less Depreciation		13,382	13,382	13,382	13,382	13,382	13,382	13,382	13,382	13,382	13,382
Taxable Income	0	10,357	12,354	14,435	16,603	18,863	21,217	23,671	26,229	28,894	31,671
Tax @	25%	2,589	3,088	3,609	4,151	4,716	5,304	5,918	6,557	7,223	7,918
After Tax Cash Flow	(138,000)	14,036	15,169	16,348	17,572	18,844	20,166	21,539	22,966	24,449	328,538
18.1% Internal Rate of Return											
Purchase	460,000							Assume a Sale at End of Year 10			
L-V	75%							Annual Rent Roll			86,253
Loan	345,000							GRM			7.6
Down Payment	115,000						annual appreciation	3.6%	Price		654,723
Cap Improvement	-							Sale Costs		6%	39,283
Closing Costs	23,000							Less: Basis			326,182
Initial Investment	138,000							Gain			289,258
Rate	5.00%							Tax @		20%	57,852
Term	25							Mortgage Balance			255,039
P&I	\$2,016.84							Sale Proceeds Before Tax			360,401
								Sale Proceeds After Tax			302,549
Mortgage Amortization		1	2	3	4	5	6	7	8	9	10
345,000	Beg Bal	345,000	337,886	330,409	322,549	314,287	305,602	296,472	286,876	276,789	266,185
5.00%	Prin	7,114	7,478	7,860	8,262	8,685	9,129	9,596	10,087	10,603	11,146
25.0	Int	17,088	16,725	16,342	15,940	15,517	15,073	14,606	14,115	13,599	13,056
2,017	Bal EOY	337,886	330,409	322,549	314,287	305,602	296,472	286,876	276,789	266,185	255,039
Cost Recovery / Depreciation		460,000	460,000	Building	80%	368,000	Land	20%	92,000	Life	27.5
		13,382	13,382	13,382	13,382	13,382	13,382	13,382	13,382	13,382	13,382
Basis		446,618	433,236	419,855	406,473	393,091	379,709	366,327	352,945	339,564	326,182