

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.

| | | |
|---------|---|-------------------------------------|
| 43,980 | + | Rental Income |
| 14,124 | - | Operating Expenses |
| 19,241 | - | Mortgage Payments |
| <hr/> | | |
| 10,615 | = | Cash Flow |
| 112,500 | / | Downpayment + Closing Costs |
| 9.4% | = | Return on Investment from Cash Flow |

2 **Appreciation**

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

| | | |
|---------|---|--|
| 375,000 | = | Acquisition Price |
| 5% | * | First Year Appreciation |
| 393,750 | = | Value at the end of Year 1. |
| <hr/> | | |
| 18,750 | = | Amount of Value Increase |
| 112,500 | / | Downpayment + Closing Costs |
| 17% | = | Return on Investment from Appreciation |

3 **Equity Build-Up**

4.75% 25 \$ 1,603.46

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

| | | |
|---------|---|---|
| 281,250 | = | Loan Amount at Closing |
| 275,238 | = | Loan Amount at the end of Year 1 |
| <hr/> | | |
| 6,012 | - | Equity Build-Up in Year 1 |
| 112,500 | / | Downpayment + Closing Costs |
| 5.3% | = | 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.

| | | |
|--------|---|---|
| 29,856 | = | Cash Flow Before Loan Payments (rents less expenses) |
| 10,625 | - | Depreciation (assumes 15% land, 30 year recovery) |
| 13,230 | - | Mortgage Interest |
| 6,002 | = | Taxable Income Year 1 |
| 33% | * | Marginal Tax Rate |
| 1,981 | = | Federal Income Tax |
| 1,981 | | Federal Income Tax |
| 10,615 | / | Cash Flow |
| 18.7% | = | Effective Tax Rate on This Investment |
| 3,503 | = | Tax if Cash Flow came from a non-preferred investment vehicle |
| 1,981 | - | Tax from this preferred investment vehicle. |
| <hr/> | | |
| 1,522 | = | Income Tax Savings |
| 1.4% | | Return on Investment from Tax Savings |

Total / Summary

| | | |
|-------|---------|-----------------------------------|
| 1: | 10,615 | Cash Flow |
| 2: | 18,750 | Appreciation Year 1 |
| 3: | 6,012 | Equity Build Up Year 1 |
| 4: | 1,522 | Tax Savings Year 1 |
| <hr/> | | |
| | 36,899 | Total Return from this Investment |
| | 112,500 | Downpayment + Closing Costs |
| | 32.8% | Total Return from this Investment |

**Illustration of Internal Rate of Return over a 10-Year Holding Period
2429 SAINT PAUL STREET**

| Purchase Price | 375,000 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 |
|--------------------------------------|------------------|--------------|---------------|---------------|---------------|---------------|---------------|---------------------|--|--------------------------|----------------|
| Annual Rent | 3.5% | 43,980 | 45,519 | 47,112 | 48,761 | 50,468 | 52,234 | 54,063 | 55,955 | 57,913 | 59,940 |
| Vacancy | 3.0% | 1,319 | 1,366 | 1,413 | 1,463 | 1,514 | 1,567 | 1,622 | 1,679 | 1,737 | 1,798 |
| Effective Income | | 42,661 | 44,154 | 45,699 | 47,299 | 48,954 | 50,667 | 52,441 | 54,276 | 56,176 | 58,142 |
| Expenses | 3.5% | 14,124 | 14,618 | 15,130 | 15,659 | 16,207 | 16,775 | 17,362 | 17,969 | 18,598 | 19,249 |
| Exp as a percent of Annual Rent | | 33% | 33% | 33% | 33% | 33% | 33% | 33% | 33% | 33% | 33% |
| Exp per unit | 4 | 3,531 | 3,655 | 3,782 | 3,915 | 4,052 | 4,194 | 4,340 | 4,492 | 4,650 | 4,812 |
| NOI | 0 | 28,537 | 29,536 | 30,569 | 31,639 | 32,747 | 33,893 | 35,079 | 36,307 | 37,577 | 38,893 |
| Debt Service | \$ 1,603 | 19,241 | 19,241 | 19,241 | 19,241 | 19,241 | 19,241 | 19,241 | 19,241 | 19,241 | 19,241 |
| Before Tax Cash Flow | (112,500) | 9,295 | 10,294 | 11,328 | 12,398 | 13,505 | 14,651 | 15,837 | 17,065 | 18,336 | 293,928 |
| 17.6% Internal Rate of Return | | | | | | | | | | | |
| NOI | | 28,537 | 29,536 | 30,569 | 31,639 | 32,747 | 33,893 | 35,079 | 36,307 | 37,577 | 38,893 |
| Less Interest | | 13,230 | 12,938 | 12,632 | 12,311 | 11,974 | 11,622 | 11,252 | 10,864 | 10,457 | 10,031 |
| Less Depreciation | | 10,000 | 10,000 | 10,000 | 10,000 | 10,000 | 10,000 | 10,000 | 10,000 | 10,000 | 10,000 |
| Taxable Income | 0 | 5,307 | 6,598 | 7,938 | 9,328 | 10,772 | 12,271 | 13,827 | 15,443 | 17,120 | 18,862 |
| Tax @ | 25% | 1,327 | 1,649 | 1,984 | 2,332 | 2,693 | 3,068 | 3,457 | 3,861 | 4,280 | 4,716 |
| After Tax Cash Flow | (112,500) | 7,969 | 8,645 | 9,343 | 10,066 | 10,812 | 11,583 | 12,381 | 13,205 | 14,056 | 248,129 |
| 14.7% Internal Rate of Return | | | | | | | | | | | |
| Purchase | 375,000 | | | | | | | | Assume a Sale at End of Year 10 | | |
| L-V | 75% | | | | | | | | Annual Rent Roll | | 59,940 |
| Loan | 281,250 | | | | | | | | GRM | | 8.5 |
| Down Payment | 93,750 | | | | | | | annual appreciation | 3.1% | Price | 511,087 |
| Cap Improvement | - | | | | | | | | | Sale Costs | 6% 30,665 |
| Closing Costs | 18,750 | | | | | | | | | Less: Basis | 275,000 |
| Initial Investment | 112,500 | | | | | | | | | Gain | 205,421 |
| Rate | 4.75% | | | | | | | | | Tax @ | 20% 41,084 |
| Term | 25 | | | | | | | | | Mortgage Balance | 206,144 |
| P&I | \$1,603.46 | | | | | | | | | Sale Proceeds Before Tax | 274,277 |
| | | | | | | | | | | Sale Proceeds After Tax | 233,193 |
| Mortgage Amortization | | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| 281,250 | Beg Bal | 281,250 | 275,238 | 268,934 | 262,325 | 255,394 | 248,127 | 240,507 | 232,517 | 224,140 | 215,355 |
| 4.75% | Prin | 6,012 | 6,304 | 6,610 | 6,931 | 7,267 | 7,620 | 7,990 | 8,378 | 8,784 | 9,211 |
| 25.0 | Int | 13,230 | 12,938 | 12,632 | 12,311 | 11,974 | 11,622 | 11,252 | 10,864 | 10,457 | 10,031 |
| 1,603 | Bal EOY | 275,238 | 268,934 | 262,325 | 255,394 | 248,127 | 240,507 | 232,517 | 224,140 | 215,355 | 206,144 |
| Cost Recovery / Depreciation | | 375,000 | 375,000 | Building | 80% | 300,000 | Land | 20% | 75,000 | Life | 30 |
| | | 10,000 | 10,000 | 10,000 | 10,000 | 10,000 | 10,000 | 10,000 | 10,000 | 10,000 | 10,000 |
| Basis | | 365,000 | 355,000 | 345,000 | 335,000 | 325,000 | 315,000 | 305,000 | 295,000 | 285,000 | 275,000 |