

## 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.

|         |   |                                     |  |
|---------|---|-------------------------------------|--|
| 123,423 | + | Rental Income                       |  |
| 34,614  | - | Operating Expenses                  |  |
| 59,326  | - | Mortgage Payments                   |  |
| <hr/>   |   |                                     |  |
| 29,483  | = | Cash Flow                           |  |
| 330,000 | / | Downpayment + Closing Costs         |  |
| 8.9%    | = | Return on Investment from Cash Flow |  |

### 2 **Appreciation**

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

|           |   |  |  |
|-----------|---|--|--|
| 1,100,000 | = | Acquisition Price                      |  |
| 5%        | * | First Year Appreciation                |  |
| 1,155,000 | = | Value at the end of Year 1.            |  |
| <hr/>     |   |  |  |
| 55,000    | = | Amount of Value Increase               |  |
| 330,000   | / | Downpayment + Closing Costs            |  |
| 17%       | = | Return on Investment from Appreciation |  |

### 3 **Equity Build-Up**

5.25%      25 \$      4,943.79

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

|         |   |   |  |
|---------|---|---|--|
| 825,000 | = | Loan Amount at Closing                    |  |
| 808,596 | = | Loan Amount at the end of Year 1          |  |
| <hr/>   |   |   |  |
| 16,404  | - | Equity Build-Up in Year 1                 |  |
| 330,000 | / | Downpayment + Closing Costs               |  |
| 5.0%    | = | 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.

|          |   |   |  |
|----------|---|---|--|
| 88,809   | = | Cash Flow Before Loan Payments (rents less expenses)          |  |
| 31,167   | - | Depreciation (assumes 15% land, 30 year recovery)             |  |
| 42,922   | - | Mortgage Interest   |  |
| 14,721   | = | Taxable Income Year 1   |  |
| 11,777   |   | Less 20% Exclusion for LLC Ownership under new tax law        |  |
| 37%      | * | Marginal Tax Rate   |  |
| 4,357.32 | = | Federal Income Tax  |  |
| 4,357    |   | Federal Income Tax  |  |
| 29,483   | / | Cash Flow   |  |
| 14.8%    | = | Effective Tax Rate on This Investment                         |  |
| 10,909   | = | Tax if Cash Flow came from a non-preferred investment vehicle |  |
| 4,357    | - | Tax from this preferred investment vehicle.                   |  |
| <hr/>    |   |   |  |
| 6,552    | = | Income Tax Savings  |  |
| 2.0%     |   | Return on Investment from Tax Savings                         |  |

### **Total / Summary**

|       |         |                                   |  |
|-------|---------|-----------------------------------|--|
| 1:    | 29,483  | Cash Flow                         |  |
| 2:    | 55,000  | Appreciation Year 1               |  |
| 3:    | 16,404  | Equity Build Up Year 1            |  |
| 4:    | 6,552   | Tax Savings Year 1                |  |
| <hr/> |         |                                   |  |
|       | 107,439 | Total Return from this Investment |  |
|       | 330,000 | Downpayment + Closing Costs       |  |
|       | 32.6%   | Total Return from this Investment |  |

**Illustration of Internal Rate of Return over a 10-Year Holding Period  
1321 EUTAW PLACE**

| Purchase Price                       | 1,100,000        | 2016          | 2017          | 2018          | 2019          | 2020          | 2021          | 2022          | 2023          | 2024          | 2025           |
|--------------------------------------|------------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|----------------|
| Annual Rent                          | 4.0%             | 127,240       | 132,330       | 137,623       | 143,128       | 148,853       | 154,807       | 160,999       | 167,439       | 174,137       | 181,102        |
| Vacancy                              | 3.0%             | 3,817         | 3,970         | 4,129         | 4,294         | 4,466         | 4,644         | 4,830         | 5,023         | 5,224         | 5,433          |
| Effective Income                     |                  | 123,423       | 128,360       | 133,494       | 138,834       | 144,387       | 150,163       | 156,169       | 162,416       | 168,913       | 175,669        |
| Expenses                             | 4.0%             | 34,614        | 35,998        | 37,438        | 38,936        | 40,493        | 42,113        | 43,798        | 45,550        | 47,372        | 49,266         |
| Exp as a percent of Annual Rent      |                  | 28%           | 28%           | 28%           | 28%           | 28%           | 28%           | 28%           | 28%           | 28%           | 28%            |
| Exp per unit                         | 7                | 4,945         | 5,143         | 5,348         | 5,562         | 5,785         | 6,016         | 6,257         | 6,507         | 6,767         | 7,038          |
| NOI                                  | 0                | 88,809        | 92,361        | 96,056        | 99,898        | 103,894       | 108,050       | 112,372       | 116,866       | 121,541       | 126,403        |
| Debt Service                         | \$ 4,944         | 59,326        | 59,326        | 59,326        | 59,326        | 59,326        | 59,326        | 59,326        | 59,326        | 59,326        | 59,326         |
| <b>Before Tax Cash Flow</b>          | <b>(330,000)</b> | <b>29,483</b> | <b>33,036</b> | <b>36,730</b> | <b>40,572</b> | <b>44,568</b> | <b>48,724</b> | <b>53,046</b> | <b>57,541</b> | <b>62,216</b> | <b>923,788</b> |
| <b>19.1% Internal Rate of Return</b> |                  |               |               |               |               |               |               |               |               |               |                |
| NOI                                  |                  | 88,809        | 92,361        | 96,056        | 99,898        | 103,894       | 108,050       | 112,372       | 116,866       | 121,541       | 126,403        |
| Less Interest                        |                  | 42,922        | 42,039        | 41,110        | 40,130        | 39,098        | 38,010        | 36,863        | 35,655        | 34,382        | 33,041         |
| Less Depreciation                    |                  | 29,333        | 29,333        | 29,333        | 29,333        | 29,333        | 29,333        | 29,333        | 29,333        | 29,333        | 29,333         |
| Taxable Income to Individuals        |                  | 16,554        | 20,989        | 25,613        | 30,435        | 35,463        | 40,707        | 46,175        | 51,878        | 57,826        | 64,029         |
| Pass Thru Entity                     | 20%              | (3,311)       | (4,198)       | (5,123)       | (6,087)       | (7,093)       | (8,141)       | (9,235)       | (10,376)      | (11,565)      | (12,806)       |
| Taxable Income                       | 0                | 13,243        | 16,791        | 20,490        | 24,348        | 28,370        | 32,565        | 36,940        | 41,502        | 46,260        | 51,223         |
| Tax @ *                              | 37%              | 4,900         | 6,213         | 7,581         | 9,009         | 10,497        | 12,049        | 13,668        | 15,356        | 17,116        | 18,953         |
| <b>After Tax Cash Flow</b>           | <b>(330,000)</b> | <b>24,583</b> | <b>26,823</b> | <b>29,149</b> | <b>31,564</b> | <b>34,071</b> | <b>36,675</b> | <b>39,378</b> | <b>42,185</b> | <b>45,099</b> | <b>771,828</b> |
| <b>15.6% Internal Rate of Return</b> |                  |               |               |               |               |               |               |               |               |               |                |
| Purchase                             | 1,100,000        |               |               |               |               |               |               |               |               |               |                |
| L-V                                  | 75%              |               |               |               |               |               |               |               |               |               | 181,102        |
| Loan                                 | 825,000          |               |               |               |               |               |               |               |               |               | 8.6            |
| Down Payment                         | 275,000          |               |               |               |               |               |               |               |               |               | 1,565,643      |
| Cap Improvement                      | -                |               |               |               |               |               |               |               |               |               | 93,939         |
| Closing Costs                        | 55,000           |               |               |               |               |               |               |               |               |               | 806,667        |
| Initial Investment                   | 330,000          |               |               |               |               |               |               |               |               |               | 665,038        |
| Rate                                 | 5.25%            |               |               |               |               |               |               |               |               |               | 133,008        |
| Term                                 | 25               |               |               |               |               |               |               |               |               |               | 614,993        |
| P&I                                  | \$4,943.79       |               |               |               |               |               |               |               |               |               | 856,711        |
|                                      |                  |               |               |               |               |               |               |               |               |               | 723,704        |
| <b>Mortgage Amortization</b>         |                  | 1             | 2             | 3             | 4             | 5             | 6             | 7             | 8             | 9             | 10             |
| 825,000 Beg Bal                      |                  | 825,000       | 808,596       | 791,310       | 773,094       | 753,898       | 733,670       | 712,354       | 689,892       | 666,222       | 641,278        |
| 5.25% Prin                           |                  | 16,404        | 17,286        | 18,216        | 19,196        | 20,228        | 21,316        | 22,462        | 23,670        | 24,943        | 26,285         |
| 25.0 Int                             |                  | 42,922        | 42,039        | 41,110        | 40,130        | 39,098        | 38,010        | 36,863        | 35,655        | 34,382        | 33,041         |
| 4,944 Bal EOY                        |                  | 808,596       | 791,310       | 773,094       | 753,898       | 733,670       | 712,354       | 689,892       | 666,222       | 641,278       | 614,993        |
| <b>Cost Recovery / Depreciation</b>  |                  | 1,100,000     | 1,100,000     | Building      | 80%           | 880,000       | Land          | 20%           | 220,000       | <b>Life</b>   | <b>30</b>      |
|                                      |                  | 29,333        | 29,333        | 29,333        | 29,333        | 29,333        | 29,333        | 29,333        | 29,333        | 29,333        | 29,333         |
| Basis                                |                  | 1,070,667     | 1,041,333     | 1,012,000     | 982,667       | 953,333       | 924,000       | 894,667       | 865,333       | 836,000       | 806,667        |

\* Tax rate of 35% applies to income of \$200,001 to \$500,000 for singles; \$400,001 to \$600,000 for married filing jointly. Marginal rate above \$500k/\$600k is 37%.