

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.

| | | |
|---------|---|-------------------------------------|
| 86,427 | + | Rental Income |
| 32,812 | - | Operating Expenses |
| 39,766 | - | Mortgage Payments |
| <hr/> | | |
| 13,850 | = | Cash Flow |
| 232,500 | / | Downpayment + Closing Costs |
| 6.0% | = | Return on Investment from Cash Flow |

2 **Appreciation**

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

| | | |
|---------|---|--|
| 775,000 | = | Acquisition Price |
| 5% | * | First Year Appreciation |
| 813,750 | = | Value at the end of Year 1. |
| <hr/> | | |
| 38,750 | = | Amount of Value Increase |
| 232,500 | / | Downpayment + Closing Costs |
| 17% | = | Return on Investment from Appreciation |

3 **Equity Build-Up**

4.75% 25 \$ 3,313.81

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

| | | |
|---------|---|---|
| 581,250 | = | Loan Amount at Closing |
| 568,826 | = | Loan Amount at the end of Year 1 |
| <hr/> | | |
| 12,424 | - | Equity Build-Up in Year 1 |
| 232,500 | / | 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.

| | | |
|----------|---|---|
| 53,615 | = | Cash Flow Before Loan Payments (rents less expenses) |
| 21,958 | - | Depreciation (assumes 15% land, 30 year recovery) |
| 27,341 | - | Mortgage Interest |
| 4,316 | = | Taxable Income Year 1 |
| 3,453 | = | Less 20% Exclusion for LLC Ownership under new tax law |
| 37% | * | Marginal Tax Rate |
| 1,277.49 | = | Federal Income Tax |
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| 13,850 | / | Cash Flow |
| 9.2% | = | Effective Tax Rate on This Investment |
| 5,124 | = | Tax if Cash Flow came from a non-preferred investment vehicle |
| 1,277 | - | Tax from this preferred investment vehicle. |
| <hr/> | | |
| 3,847 | = | Income Tax Savings |
| 1.7% | = | Return on Investment from Tax Savings |

Total / Summary

| | | |
|-------|---------|-----------------------------------|
| 1: | 13,850 | Cash Flow |
| 2: | 38,750 | Appreciation Year 1 |
| 3: | 12,424 | Equity Build Up Year 1 |
| 4: | 3,847 | Tax Savings Year 1 |
| <hr/> | | |
| | 68,871 | Total Return from this Investment |
| | 232,500 | Downpayment + Closing Costs |
| | 29.6% | Total Return from this Investment |

