## 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.
116,400 + Rental Income
35,852 - Operating Expenses
53,632 - Mortgage Payments
26,916 = Cash Flow
330,000 / Downpayment + Closing Costs
8.2\% = Return on Investment from Cash Flow

## 2 Appreciation

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

| $1,100,000$ | $=$ Acquisiton Price |
| ---: | :--- |
| $3 \%$ | $*$ First Year Appreciation |
| $1,133,000$ | $=$ Value at the end of Year 1. |
| 33,000 | $=$ Amount of Value Increase |
| 330,000 | $/$ Downpayment + Closing Costs |
| $10 \%$ | $=$ 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.

825,000 = Loan Amount at Closing

| $806,064=$ Loan Amount at the end of Year 1 |
| ---: |
| $18,936-$ Equity Build-Up in Year 1 |

330,000 / Downpayment + Closing Costs
$5.7 \%=$ 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.

80,548 = Cash Flow Before Loan Payments (rents less expenses)
31,167 - Depreciation (assumes 15\% land, 30 year recovery)
34,696 - Mortgage Interest
14,685 = Taxable Income Year 1
11,748 Less 20\% Exclusion for LLC Ownership under new tax law
37\% * Marginal Tax Rate
4,346.76 = Federal Income Tax
4,347 Federal Income Tax
26,916 / Cash Flow
16.1\% = Effective Tax Rate on This Investment

9,959 = Tax if Cash Flow came from a non-preferred investment vehicle
4,347 - Tax from this preferred investment vehicle.
$5,612=$ Income Tax Savings
1.7\% Return on Investment from Tax Savings

Total / Summary

| 1: | 26,916 | Cash Flow |
| ---: | ---: | :--- |
| 2: | 33,000 | Appreciation Year 1 |
| 3: | 18,936 | Equity Build Up Year 1 |
| 4: | 5,612 | Tax Savings Year 1 |
|  | 84,464 | Total Return from this Investment |
|  | 330,000 | Downpayment + Closing Costs |
|  | $25.6 \%$ | Total Return from this Investment |


| IIlustration of Internal Rate of Return over a 10-Year Holding Period 1321 EUTAW PLACE |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Purchase Price | 1,100,000 | 2021 | $\underline{2022}$ | 2023 | $\underline{2024}$ | $\underline{2025}$ | 2026 | 2027 | $\underline{2028}$ | 2029 | 2030 |
| Annual Rent | 3.0\% | 120,000 | 123,600 | 127,308 | 131,127 | 135,061 | 139,113 | 143,286 | 147,585 | 152,012 | 156,573 |
| Vacancy | 3.0\% | 3,600 | 3,708 | 3,819 | 3,934 | 4,052 | 4,173 | 4,299 | 4,428 | 4,560 | 4,697 |
| Effective Income |  | 116,400 | 119,892 | 123,489 | 127,193 | 131,009 | 134,940 | 138,988 | 143,157 | 147,452 | 151,876 |
| Expenses | 3.0\% | 35,852 | 36,927 | 38,035 | 39,176 | 40,352 | 41,562 | 42,809 | 44,093 | 45,416 | 46,779 |
| Exp as a percent of Annu | al Rent | 31\% | 31\% | 31\% | 31\% | 31\% | 31\% | 31\% | 31\% | 31\% | 31\% |
| Exp per unit | 7 | 5,122 | 5,275 | 5,434 | 5,597 | 5,765 | 5,937 | 6,116 | 6,299 | 6,488 | 6,683 |
| NOI | 0 | 80,548 | 82,965 | 85,454 | 88,017 | 90,658 | 93,377 | 96,179 | 99,064 | 102,036 | 105,097 |
| Debt Service | \$ 4,469 | 53,632 | 53,632 | 53,632 | 53,632 | 53,632 | 53,632 | 53,632 | 53,632 | 53,632 | 53,632 |
| Before Tax Cash Flow | $(330,000)$ | 26,916 | 29,333 | 31,821 | 34,385 | 37,026 | 39,745 | 42,547 | 45,432 | 48,404 | 806,493 |
| 16.6\% Internal Rate of Return |  |  |  |  |  |  |  |  |  |  |  |
| NOI |  | 80,548 | 82,965 | 85,454 | 88,017 | 90,658 | 93,377 | 96,179 | 99,064 | 102,036 | 105,097 |
| Less Interest |  | 34,696 | 33,876 | 33,020 | 32,126 | 31,194 | 30,222 | 29,207 | 28,149 | 27,045 | 25,892 |
| 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 Individ | duals | 16,518 | 19,755 | 23,101 | 26,557 | 30,130 | 33,822 | 37,638 | 41,582 | 45,658 | 49,871 |
| Pass Thru Entity | 20\% | $(3,304)$ | $(3,951)$ | $(4,620)$ | $(5,311)$ | $(6,026)$ | $(6,764)$ | $(7,528)$ | $(8,316)$ | $(9,132)$ | $(9,974)$ |
| Taxable Income | 0 | 13,215 | 15,804 | 18,480 | 21,246 | 24,104 | 27,058 | 30,110 | 33,265 | 36,526 | 39,897 |
| Tax @ * | 37\% | 4,889 | 5,848 | 6,838 | 7,861 | 8,918 | 10,011 | 11,141 | 12,308 | 13,515 | 14,762 |
| After Tax Cash Flow | $(330,000)$ | 22,027 | 23,485 | 24,984 | 26,524 | 28,107 | 29,734 | 31,406 | 33,124 | 34,889 | 683,238 |
| 13.4\% Internal Rate of Return |  |  |  |  |  |  |  |  |  |  |  |
| Purchase | 1,100,000 |  |  |  |  |  |  | Assume a Sale at End of Year 10 |  |  |  |
| L-V | 75\% |  |  |  |  |  |  | Annual Rent Roll |  |  | 156,573 |
| Loan | 825,000 |  |  |  |  |  |  | GRM |  |  | 9.2 |
| Down Payment | 275,000 |  |  |  | annual appreciation |  | 2.7\% | Price |  |  | 1,435,251 |
| Cap Improvement | - |  |  |  |  |  |  | Sale Costs |  | 6\% | 86,115 |
| Closing Costs | 55,000 |  |  |  |  |  |  | Less: Basis |  |  | 806,667 |
| Initial Investment | 330,000 |  |  |  |  |  |  | Gain |  |  | 542,469 |
| Rate | 4.25\% |  |  |  |  |  |  | Tax @ |  | 20\% | 108,494 |
| Term | 25 |  |  |  |  |  |  | Mortgage Balance |  |  | 594,107 |
| P\&1 | \$4,469.34 |  |  |  |  |  |  | Sale Proceeds Before Tax |  |  | 755,028 |
|  |  |  |  |  |  |  |  | Sale Proceeds After Tax |  |  | 646,535 |
| Mortgage Amortization |  | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| 825,000 | Beg Bal | 825,000 | 806,064 | 786,308 | 765,696 | 744,190 | 721,752 | 698,342 | 673,918 | 648,434 | 621,847 |
| 4.25\% | Prin | 18,936 | 19,756 | 20,612 | 21,506 | 22,438 | 23,410 | 24,425 | 25,483 | 26,588 | 27,740 |
| 25.0 | Int | 34,696 | 33,876 | 33,020 | 32,126 | 31,194 | 30,222 | 29,207 | 28,149 | 27,045 | 25,892 |
| 4,469 | Bal EOY | 806,064 | 786,308 | 765,696 | 744,190 | 721,752 | 698,342 | 673,918 | 648,434 | 621,847 | 594,107 |
| Cost Recovery / Depreciation |  | 1,100,000 | 1,100,000 | Building | 80\% | 880,000 | Land | 20\% | 220,000 | Life | 30 |
|  |  | 29,333 | 29,333 | 29,333 | 29,333 | 29,333 | 29,333 | 29,333 | 29,333 | 29,333 | 29,333 |
| Basis |  | \#\#\#\#\#\#:399: | \#\#\#\#\#1374/666 | \#\#\#\#\#\# 1 45/333 |  | \#\#\#\#\#\#86/666 | \#\#\#\#\#\#57/333 |  | \#\#\#\#\#\#198/666 | \#\#\#\#\#\#69/333 | \#\#\#\#\#\#39 ${ }^{\text {a }}$ : |

