

## 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.

61,740	+	Rental Income
19,728	-	Operating Expenses
22,228	-	Mortgage Payments
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19,785	=	Cash Flow
165,000	/	Downpayment + Closing Costs
12.0%	=	Return on Investment from Cash Flow

### 2 Appreciation

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

550,000	=	Acquisition Price
5%	*	First Year Appreciation
577,500	=	Value at the end of Year 1.
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27,500	=	Amount of Value Increase
165,000	/	Downpayment + Closing Costs
17%	=	Return on Investment from Appreciation

### 3 Equity Build-Up

3.50% 30 \$ 1,852.31

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

412,500	=	Loan Amount at Closing
404,584	=	Loan Amount at the end of Year 1
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7,916	-	Equity Build-Up in Year 1
165,000	/	Downpayment + Closing Costs
4.8%	=	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.

42,012	=	Cash Flow Before Loan Payments (rents less expenses)
15,583	-	Depreciation (assumes 15% land, 30 year recovery)
14,311	-	Mortgage Interest
12,118	=	Taxable Income Year 1
9,694		Less 20% Exclusion for LLC Ownership under new tax law
37%	*	Marginal Tax Rate
3,586.85	=	Federal Income Tax
3,587		Federal Income Tax
19,785	/	Cash Flow
18.1%	=	Effective Tax Rate on This Investment
7,320	=	Tax if Cash Flow came from a non-preferred investment vehicle
3,587	-	Tax from this preferred investment vehicle.
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3,733	=	Income Tax Savings
2.3%		Return on Investment from Tax Savings

### Total / Summary

1:	19,785	Cash Flow
2:	27,500	Appreciation Year 1
3:	7,916	Equity Build Up Year 1
4:	3,733	Tax Savings Year 1
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	58,935	Total Return from this Investment
	165,000	Downpayment + Closing Costs
	35.7%	Total Return from this Investment

**Illustration of Internal Rate of Return over a 10-Year Holding Period**  
**2647 NORTH CHARLES STREET**

Purchase Price	550,000	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Annual Rent	4.0%	61,740	64,210	66,778	69,449	72,227	75,116	78,121	81,246	84,495	87,875
Vacancy	3.0%	1,852	1,926	2,003	2,083	2,167	2,253	2,344	2,437	2,535	2,636
Effective Income		59,888	62,283	64,775	67,366	70,060	72,863	75,777	78,808	81,961	85,239
Expenses	4.0%	19,728	20,517	21,337	22,191	23,079	24,002	24,962	25,960	26,999	28,079
Exp as a percent of Annual Rent		33%	33%	33%	33%	33%	33%	33%	33%	33%	33%
Exp per unit	4	4,932	5,129	5,334	5,548	5,770	6,000	6,240	6,490	6,750	7,020
NOI	0	40,160	41,767	43,437	45,175	46,982	48,861	50,815	52,848	54,962	57,160
Debt Service	\$ 1,852	22,228	22,228	22,228	22,228	22,228	22,228	22,228	22,228	22,228	22,228
<b>Before Tax Cash Flow</b>	<b>(165,000)</b>	<b>17,932</b>	<b>19,539</b>	<b>21,210</b>	<b>22,947</b>	<b>24,754</b>	<b>26,633</b>	<b>28,588</b>	<b>30,620</b>	<b>32,734</b>	<b>451,399</b>
<b>20.0%</b> Internal Rate of Return											

NOI		40,160	41,767	43,437	45,175	46,982	48,861	50,815	52,848	54,962	57,160
Less Interest		14,311	14,030	13,738	13,436	13,124	12,800	12,464	12,117	11,758	11,385
Less Depreciation		14,667	14,667	14,667	14,667	14,667	14,667	14,667	14,667	14,667	14,667
Taxable Income to Individuals		11,182	13,070	15,032	17,072	19,192	21,395	23,684	26,064	28,538	31,109
Pass Thru Entity	20%	(2,236)	(2,614)	(3,006)	(3,414)	(3,838)	(4,279)	(4,737)	(5,213)	(5,708)	(6,222)
Taxable Income	0	8,946	10,456	12,026	13,657	15,353	17,116	18,947	20,851	22,830	24,887
Tax @ *	37%	3,310	3,869	4,450	5,053	5,681	6,333	7,011	7,715	8,447	9,208
<b>After Tax Cash Flow</b>	<b>(165,000)</b>	<b>14,623</b>	<b>15,670</b>	<b>16,760</b>	<b>17,894</b>	<b>19,073</b>	<b>20,300</b>	<b>21,577</b>	<b>22,905</b>	<b>24,287</b>	<b>375,687</b>
<b>16.3%</b> Internal Rate of Return											

Purchase	550,000											<b>Assume a Sale at End of Year 10</b>		
L-V	75%											Annual Rent Roll	87,875	
Loan	412,500											GRM	8.9	
Down Payment	137,500					annual appreciation	3.6%					Price	782,821	
Cap Improvement	-											Sale Costs	6%	46,969
Closing Costs	27,500											Less: Basis		403,333
Initial Investment	165,000											Gain		332,519
Rate	3.50%											Tax @	20%	66,504
Term	30											Mortgage Balance		319,386
P&I	\$1,852.31											Sale Proceeds Before Tax		416,466
												Sale Proceeds After Tax		349,963

Mortgage Amortization		1	2	3	4	5	6	7	8	9	10
412,500 Beg Bal		412,500	404,584	396,386	387,896	379,105	370,000	360,572	350,809	340,699	330,228
3.50% Prin		7,916	8,198	8,490	8,791	9,104	9,428	9,763	10,111	10,470	10,843
30.0 Int		14,311	14,030	13,738	13,436	13,124	12,800	12,464	12,117	11,758	11,385
1,852 Bal EOY		404,584	396,386	387,896	379,105	370,000	360,572	350,809	340,699	330,228	319,386
<b>Cost Recovery / Depreciation</b>		550,000	550,000	Building	80%	440,000	Land	20%	110,000	<b>Life</b>	<b>30</b>
Basis		14,667	14,667	14,667	14,667	14,667	14,667	14,667	14,667	14,667	14,667
		535,333	520,667	506,000	491,333	476,667	462,000	447,333	432,667	418,000	403,333

\* 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%.