

## 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.

67,221	+	Rental Income
20,973	-	Operating Expenses
33,116	-	Mortgage Payments
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13,132	=	Cash Flow
220,500	/	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.

735,000	=	Acquisition Price
5%	*	First Year Appreciation
771,750	=	Value at the end of Year 1.
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36,750	=	Amount of Value Increase
220,500	/	Downpayment + Closing Costs
17%	=	Return on Investment from Appreciation

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

3.50% 25 \$ 2,759.69

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

551,250	=	Loan Amount at Closing
537,204	=	Loan Amount at the end of Year 1
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14,046	=	Equity Build-Up in Year 1
220,500	/	Downpayment + Closing Costs
6.4%	=	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.

46,248	=	Cash Flow Before Loan Payments (rents less expenses)
20,825	-	Depreciation (assumes 15% land, 30 year recovery)
19,070	-	Mortgage Interest
6,354	=	Taxable Income Year 1
5,083	=	Less 20% Exclusion for LLC Ownership under new tax law
37%	*	Marginal Tax Rate
1,880.66	=	Federal Income Tax
1,881	=	Federal Income Tax
13,132	/	Cash Flow
14.3%	=	Effective Tax Rate on This Investment
4,859	=	Tax if Cash Flow came from a non-preferred investment vehicle
1,881	-	Tax from this preferred investment vehicle.
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2,978	=	Income Tax Savings
1.4%	=	Return on Investment from Tax Savings

### **Total / Summary**

1:	13,132	Cash Flow
2:	36,750	Appreciation Year 1
3:	14,046	Equity Build Up Year 1
4:	2,978	Tax Savings Year 1
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	66,907	Total Return from this Investment
	220,500	Downpayment + Closing Costs
	30.3%	Total Return from this Investment

**Illustration of Internal Rate of Return over a 10-Year Holding Period**  
**1420 LIGHT STREET**

Purchase Price	735,000	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
Annual Rent	3.0%	69,300	71,379	73,520	75,726	77,998	80,338	82,748	85,230	87,787	90,421
Vacancy	3.0%	2,079	2,141	2,206	2,272	2,340	2,410	2,482	2,557	2,634	2,713
Effective Income		67,221	69,238	71,315	73,454	75,658	77,928	80,265	82,673	85,154	87,708
Expenses	3.0%	20,973	21,602	22,250	22,917	23,605	24,313	25,042	25,794	26,567	27,364
Exp as a percent of Annual Rent		31%	31%	31%	31%	31%	31%	31%	31%	31%	31%
Exp per unit	5	4,195	4,320	4,450	4,583	4,721	4,863	5,008	5,159	5,313	5,473
NOI	0	46,248	47,636	49,065	50,537	52,053	53,615	55,223	56,880	58,586	60,344
Debt Service	\$ 2,760	33,116	33,116	33,116	33,116	33,116	33,116	33,116	33,116	33,116	33,116
<b>Before Tax Cash Flow</b>	<b>(220,500)</b>	<b>13,132</b>	<b>14,520</b>	<b>15,949</b>	<b>17,421</b>	<b>18,937</b>	<b>20,498</b>	<b>22,107</b>	<b>23,763</b>	<b>25,470</b>	<b>542,662</b>
<b>14.9% Internal Rate of Return</b>											
NOI		46,248	47,636	49,065	50,537	52,053	53,615	55,223	56,880	58,586	60,344
Less Interest		19,070	18,570	18,053	17,517	16,962	16,388	15,793	15,177	14,539	13,878
Less Depreciation		19,600	19,600	19,600	19,600	19,600	19,600	19,600	19,600	19,600	19,600
Taxable Income to Individuals		7,579	9,466	11,412	13,420	15,491	17,627	19,830	22,103	24,448	26,866
Pass Thru Entity	20%	(1,516)	(1,893)	(2,282)	(2,684)	(3,098)	(3,525)	(3,966)	(4,421)	(4,890)	(5,373)
Taxable Income	0	6,063	7,573	9,130	10,736	12,393	14,101	15,864	17,682	19,558	21,493
Tax @ *	37%	2,243	2,802	3,378	3,972	4,585	5,218	5,870	6,543	7,236	7,952
<b>After Tax Cash Flow</b>	<b>(220,500)</b>	<b>10,889</b>	<b>11,718</b>	<b>12,571</b>	<b>13,448</b>	<b>14,352</b>	<b>15,281</b>	<b>16,237</b>	<b>17,221</b>	<b>18,233</b>	<b>462,216</b>
<b>12.1% Internal Rate of Return</b>											
Purchase	735,000							<b>Assume a Sale at End of Year 10</b>			
L-V	75%							Annual Rent Roll			90,421
Loan	551,250							GRM			10.6
Down Payment	183,750							Price			959,008
Cap Improvement	-							Sale Costs		6%	57,540
Closing Costs	36,750							Less: Basis			539,000
Initial Investment	220,500							Gain			362,468
Rate	3.50%							Tax @		20%	72,494
Term	25							Mortgage Balance			386,034
P&I	\$2,759.69							Sale Proceeds Before Tax			515,434
								Sale Proceeds After Tax			442,941
<b>Mortgage Amortization</b>		1	2	3	4	5	6	7	8	9	10
551,250 Beg Bal		551,250	537,204	522,658	507,594	491,995	475,841	459,113	441,789	423,850	405,272
3.50% Prin		14,046	14,546	15,063	15,599	16,154	16,728	17,323	17,940	18,578	19,238
25.0 Int		19,070	18,570	18,053	17,517	16,962	16,388	15,793	15,177	14,539	13,878
2,760 Bal EOY		537,204	522,658	507,594	491,995	475,841	459,113	441,789	423,850	405,272	386,034
<b>Cost Recovery / Depreciation</b>		735,000	735,000	Building	80%	588,000	Land	20%	147,000	Life	30
		19,600	19,600	19,600	19,600	19,600	19,600	19,600	19,600	19,600	19,600
Basis		715,400	695,800	676,200	656,600	637,000	617,400	597,800	578,200	558,600	539,000
* 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%.											