

## 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.

39,084	+	Rental Income
12,903	-	Operating Expenses
11,922	-	Mortgage Payments
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14,259	=	Cash Flow
88,500	/	Downpayment + Closing Costs
16.1%	=	Return on Investment from Cash Flow

### 2 **Appreciation**

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

295,000	=	Acquisition Price
5%	*	First Year Appreciation
309,750	=	Value at the end of Year 1.
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14,750	=	Amount of Value Increase
88,500	/	Downpayment + Closing Costs
17%	=	Return on Investment from Appreciation

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

3.50% 30 \$ 993.51

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

221,250	=	Loan Amount at Closing
217,004	=	Loan Amount at the end of Year 1
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4,246	-	Equity Build-Up in Year 1
88,500	/	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.

26,181	=	Cash Flow Before Loan Payments (rents less expenses)
8,358	-	Depreciation (assumes 15% land, 30 year recovery)
7,676	-	Mortgage Interest
10,147	=	Taxable Income Year 1
8,117		Less 20% Exclusion for LLC Ownership under new tax law
37%	*	Marginal Tax Rate
3,003.46	=	Federal Income Tax
3,003		Federal Income Tax
14,259	/	Cash Flow
21.1%	=	Effective Tax Rate on This Investment
5,276	=	Tax if Cash Flow came from a non-preferred investment vehicle
3,003	-	Tax from this preferred investment vehicle.
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2,272	=	Income Tax Savings
2.6%		Return on Investment from Tax Savings

### **Total / Summary**

1:	14,259	Cash Flow
2:	14,750	Appreciation Year 1
3:	4,246	Equity Build Up Year 1
4:	2,272	Tax Savings Year 1
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	35,528	Total Return from this Investment
	88,500	Downpayment + Closing Costs
	40.1%	Total Return from this Investment

**Illustration of Internal Rate of Return over a 10-Year Holding Period**  
**3422 CHESTNUT AVENUE**

Purchase Price	295,000	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
Annual Rent	4.0%	39,084	40,647	42,273	43,964	45,723	47,552	49,454	51,432	53,489	55,629
Vacancy	3.0%	1,173	1,219	1,268	1,319	1,372	1,427	1,484	1,543	1,605	1,669
Effective Income		37,911	39,428	41,005	42,645	44,351	46,125	47,970	49,889	51,884	53,960
Expenses	4.0%	12,903	13,419	13,956	14,514	15,094	15,698	16,326	16,979	17,658	18,365
Exp as a percent of Annual Rent		34%	34%	34%	34%	34%	34%	34%	34%	34%	34%
Exp per unit	3	4,301	4,473	4,652	4,838	5,031	5,233	5,442	5,660	5,886	6,122
NOI	0	25,009	26,009	27,049	28,131	29,257	30,427	31,644	32,910	34,226	35,595
Debt Service	\$ 994	11,922	11,922	11,922	11,922	11,922	11,922	11,922	11,922	11,922	11,922
Before Tax Cash Flow	(88,500)	13,087	14,087	15,127	16,209	17,334	18,505	19,722	20,988	22,304	247,050
<b>23.3% Internal Rate of Return</b>											
NOI		25,009	26,009	27,049	28,131	29,257	30,427	31,644	32,910	34,226	35,595
Less Interest		7,676	7,525	7,369	7,207	7,039	6,865	6,685	6,499	6,306	6,107
Less Depreciation		7,867	7,867	7,867	7,867	7,867	7,867	7,867	7,867	7,867	7,867
Taxable Income to Individuals		9,466	10,617	11,814	13,058	14,351	15,695	17,092	18,544	20,053	21,622
Pass Thru Entity	20%	(1,893)	(2,123)	(2,363)	(2,612)	(2,870)	(3,139)	(3,418)	(3,709)	(4,011)	(4,324)
Taxable Income	0	7,573	8,494	9,451	10,446	11,481	12,556	13,673	14,835	16,043	17,298
Tax @ *	37%	2,802	3,143	3,497	3,865	4,248	4,646	5,059	5,489	5,936	6,400
After Tax Cash Flow	(88,500)	10,285	10,944	11,630	12,344	13,087	13,859	14,663	15,499	16,368	204,980
<b>18.8% Internal Rate of Return</b>											
Purchase	295,000							<b>Assume a Sale at End of Year 10</b>			
L-V	75%							Annual Rent Roll			55,629
Loan	221,250							GRM			7.5
Down Payment	73,750							Price			419,877
Cap Improvement	-							Sale Costs		6%	25,193
Closing Costs	14,750							Less: Basis			216,333
Initial Investment	88,500							Gain			178,351
Rate	3.50%							Tax @		20%	35,670
Term	30							Mortgage Balance			171,307
P&I	\$993.51							Sale Proceeds Before Tax			223,377
								Sale Proceeds After Tax			187,707
<b>Mortgage Amortization</b>		1	2	3	4	5	6	7	8	9	10
221,250 Beg Bal		221,250	217,004	212,607	208,053	203,338	198,455	193,398	188,161	182,738	177,123
3.50% Prin		4,246	4,397	4,553	4,715	4,883	5,057	5,237	5,423	5,616	5,816
30.0 Int		7,676	7,525	7,369	7,207	7,039	6,865	6,685	6,499	6,306	6,107
994 Bal EOY		217,004	212,607	208,053	203,338	198,455	193,398	188,161	182,738	177,123	171,307
<b>Cost Recovery / Depreciation</b>		295,000	295,000	Building	80%	236,000	Land	20%	59,000	<b>Life</b>	<b>30</b>
		7,867	7,867	7,867	7,867	7,867	7,867	7,867	7,867	7,867	7,867
Basis		287,133	279,267	271,400	263,533	255,667	247,800	239,933	232,067	224,200	216,333

\* 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%.