

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.

25,200	+	Rental Income
7,335	-	Operating Expenses
10,777	-	Mortgage Payments
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7,088	=	Cash Flow
62,500	/	Downpayment + Closing Costs
7.0%	=	Return on Investment from Cash Flow

2 **Appreciation**

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

250,000	=	Acquisition Price
5%	*	First Year Appreciation
262,500	=	Value at the end of Year 1.
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12,500	=	Amount of Value Increase
62,500	/	Downpayment + Closing Costs
20%	=	Return on Investment from Appreciation

3 **Equity Build-Up**

3.50% 30 \$ 898.09

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

200,000	=	Loan Amount at Closing
196,162	=	Loan Amount at the end of Year 1
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3,838	-	Equity Build-Up in Year 1
62,500	/	Downpayment + Closing Costs
6.1%	=	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.

17,865	=	Cash Flow Before Loan Payments (rents less expenses)
7,083	-	Depreciation (assumes 15% land, 30 year recovery)
6,939	-	Mortgage Interest
3,842	=	Taxable Income Year 1
3,074		Less 20% Exclusion for LLC Ownership under new tax law
37%	*	Marginal Tax Rate
1,137.37	=	Federal Income Tax
1,137		Federal Income Tax
7,088	/	Cash Flow
16.0%	=	Effective Tax Rate on This Investment
2,622	=	Tax if Cash Flow came from a non-preferred investment vehicle
1,137	-	Tax from this preferred investment vehicle.
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1,485	=	Income Tax Savings
2.4%	=	Return on Investment from Tax Savings

Total / Summary

1:	7,088	Cash Flow
2:	12,500	Appreciation Year 1
3:	3,838	Equity Build Up Year 1
4:	1,485	Tax Savings Year 1
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	24,911	Total Return from this Investment
	62,500	Downpayment + Closing Costs
	39.9%	Total Return from this Investment

Illustration of Internal Rate of Return over a 10-Year Holding Period

818 E. 35th STREET

Purchase Price	250,000	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	
Annual Rent	4.0%	25,200	26,208	27,256	28,347	29,480	30,660	31,886	33,161	34,488	35,867	
Vacancy	3.0%	756	786	818	850	884	920	957	995	1,035	1,076	
Effective Income		24,444	25,422	26,439	27,496	28,596	29,740	30,929	32,167	33,453	34,791	
Expenses	4.0%	7,335	7,629	7,934	8,251	8,581	8,925	9,282	9,653	10,039	10,441	
Exp as a percent of Annual Rent		30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	
Exp per unit	2	3,668	3,814	3,967	4,126	4,291	4,462	4,641	4,826	5,020	5,220	
NOI	0	17,109	17,793	18,505	19,245	20,015	20,815	21,648	22,514	23,414	24,351	
Debt Service	\$ 898	10,777	10,777	10,777	10,777	10,777	10,777	10,777	10,777	10,777	10,777	
Before Tax Cash Flow	(62,500)	6,332	7,016	7,728	8,468	9,238	10,038	10,871	11,737	12,637	193,198	
20.7% Internal Rate of Return												
NOI		17,109	17,793	18,505	19,245	20,015	20,815	21,648	22,514	23,414	24,351	
Less Interest		6,939	6,802	6,661	6,515	6,363	6,206	6,043	5,875	5,701	5,520	
Less Depreciation		6,667	6,667	6,667	6,667	6,667	6,667	6,667	6,667	6,667	6,667	
Taxable Income to Individuals		3,503	4,324	5,177	6,064	6,985	7,943	8,938	9,972	11,047	12,164	
Pass Thru Entity	20%	(701)	(865)	(1,035)	(1,213)	(1,397)	(1,589)	(1,788)	(1,994)	(2,209)	(2,433)	
Taxable Income	0	2,802	3,459	4,142	4,851	5,588	6,354	7,150	7,978	8,838	9,731	
Tax @ *	37%	1,037	1,280	1,532	1,795	2,068	2,351	2,646	2,952	3,270	3,601	
After Tax Cash Flow	(62,500)	5,295	5,736	6,195	6,673	7,170	7,687	8,225	8,785	9,367	159,369	
17.1% Internal Rate of Return												
Purchase	250,000								Assume a Sale at End of Year 10			
L-V	80%								Annual Rent Roll		35,867	
Loan	200,000								GRM		9.9	
Down Payment	50,000							annual appreciation	3.6%	Price	355,828	
Cap Improvement	-									Sale Costs	6%	21,350
Closing Costs	12,500									Less: Basis		183,333
Initial Investment	62,500									Gain		151,145
Rate	3.50%									Tax @	20%	30,229
Term	30									Mortgage Balance		154,854
P&I	\$898.09									Sale Proceeds Before Tax		179,625
										Sale Proceeds After Tax		149,396
Mortgage Amortization		1	2	3	4	5	6	7	8	9	10	
200,000 Beg Bal		200,000	196,162	192,187	188,071	183,808	179,394	174,823	170,089	165,187	160,111	
3.50% Prin		3,838	3,975	4,116	4,263	4,414	4,571	4,734	4,902	5,076	5,257	
30.0 Int		6,939	6,802	6,661	6,515	6,363	6,206	6,043	5,875	5,701	5,520	
898 Bal EOY		196,162	192,187	188,071	183,808	179,394	174,823	170,089	165,187	160,111	154,854	
Cost Recovery / Depreciation		250,000	250,000	Building	80%	200,000	Land	20%	50,000	Life	30	
		6,667	6,667	6,667	6,667	6,667	6,667	6,667	6,667	6,667	6,667	
Basis		243,333	236,667	230,000	223,333	216,667	210,000	203,333	196,667	190,000	183,333	

* 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%.