

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.

79,789	+	Rental Income
33,775	-	Operating Expenses
32,082	-	Mortgage Payments
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13,932	=	Cash Flow
162,500	/	Downpayment + Closing Costs
8.6%	=	Return on Investment from Cash Flow

2 **Appreciation**

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

650,000	=	Acquisition Price
5%	*	First Year Appreciation
682,500	=	Value at the end of Year 1.
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32,500	=	Amount of Value Increase
162,500	/	Downpayment + Closing Costs
20%	=	Return on Investment from Appreciation

3 **Equity Build-Up**

3.75% 25 \$ 2,673.48

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

520,000	=	Loan Amount at Closing
507,200	=	Loan Amount at the end of Year 1
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12,800	-	Equity Build-Up in Year 1
162,500	/	Downpayment + Closing Costs
7.9%	=	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.

46,013	=	Cash Flow Before Loan Payments (rents less expenses)
18,417	-	Depreciation (assumes 15% land, 30 year recovery)
19,281	-	Mortgage Interest
8,315	=	Taxable Income Year 1
6,652		Less 20% Exclusion for LLC Ownership under new tax law
37%	*	Marginal Tax Rate
2,461.28	=	Federal Income Tax
2,461		Federal Income Tax
13,932	/	Cash Flow
17.7%	=	Effective Tax Rate on This Investment
5,155	=	Tax if Cash Flow came from a non-preferred investment vehicle
2,461	-	Tax from this preferred investment vehicle.
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2,693	=	Income Tax Savings
1.7%		Return on Investment from Tax Savings

Total / Summary

1:	13,932	Cash Flow
2:	32,500	Appreciation Year 1
3:	12,800	Equity Build Up Year 1
4:	2,693	Tax Savings Year 1
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	61,925	Total Return from this Investment
	162,500	Downpayment + Closing Costs
	38.1%	Total Return from this Investment

**Illustration of Internal Rate of Return over a 10-Year Holding Period
616 HOMESTEAD ST.**

Purchase Price	650,000	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
Annual Rent	3.0%	83,988	86,508	89,103	91,776	94,529	97,365	100,286	103,295	106,393	109,585
Vacancy	3.0%	2,520	2,595	2,673	2,753	2,836	2,921	3,009	3,099	3,192	3,288
Effective Income		81,468	83,912	86,430	89,023	91,693	94,444	97,277	100,196	103,202	106,298
Expenses	3.0%	33,775	34,789	35,832	36,907	38,014	39,155	40,329	41,539	42,786	44,069
Exp as a percent of Annual Rent		41%	41%	41%	41%	41%	41%	41%	41%	41%	41%
Exp per unit	7	4,825	4,970	5,119	5,272	5,431	5,594	5,761	5,934	6,112	6,296
NOI	0	47,693	49,124	50,598	52,115	53,679	55,289	56,948	58,656	60,416	62,229
Debt Service	\$ 2,673	32,082	32,082	32,082	32,082	32,082	32,082	32,082	32,082	32,082	32,082
Before Tax Cash Flow	(162,500)	15,611	17,042	18,516	20,034	21,597	23,208	24,866	26,575	28,334	459,734
19.2% Internal Rate of Return											
NOI		47,693	49,124	50,598	52,115	53,679	55,289	56,948	58,656	60,416	62,229
Less Interest		19,281	18,793	18,286	17,760	17,213	16,646	16,057	15,446	14,811	14,152
Less Depreciation		17,333	17,333	17,333	17,333	17,333	17,333	17,333	17,333	17,333	17,333
Taxable Income to Individuals		11,078	12,997	14,978	17,022	19,132	21,310	23,557	25,877	28,272	30,743
Pass Thru Entity	20%	(2,216)	(2,599)	(2,996)	(3,404)	(3,826)	(4,262)	(4,711)	(5,175)	(5,654)	(6,149)
Taxable Income	0	8,863	10,398	11,982	13,618	15,306	17,048	18,846	20,702	22,617	24,594
Tax @ *	37%	3,279	3,847	4,434	5,039	5,663	6,308	6,973	7,660	8,368	9,100
After Tax Cash Flow	(162,500)	12,332	13,195	14,082	14,995	15,934	16,900	17,893	18,915	19,966	386,524
15.5% Internal Rate of Return											
Purchase	650,000										
L-V	80%										109,585
Loan	520,000										7.7
Down Payment	130,000										848,103
Cap Improvement	-									6%	50,886
Closing Costs	32,500										476,667
Initial Investment	162,500										320,550
Rate	3.75%									20%	64,110
Term	25										367,629
P&I	\$2,673.48										429,587
											365,477
Mortgage Amortization		1	2	3	4	5	6	7	8	9	10
520,000 Beg Bal		520,000	507,200	493,911	480,115	465,793	450,925	435,490	419,465	402,829	385,559
3.75% Prin		12,800	13,289	13,796	14,322	14,868	15,436	16,024	16,636	17,271	17,929
25.0 Int		19,281	18,793	18,286	17,760	17,213	16,646	16,057	15,446	14,811	14,152
2,673 Bal EOY		507,200	493,911	480,115	465,793	450,925	435,490	419,465	402,829	385,559	367,629
Cost Recovery / Depreciation		650,000	650,000	Building	80%	520,000	Land	20%	130,000	Life	30
		17,333	17,333	17,333	17,333	17,333	17,333	17,333	17,333	17,333	17,333
Basis		632,667	615,333	598,000	580,667	563,333	546,000	528,667	511,333	494,000	476,667

* 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%.