## 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.

| 52,768 | + Rental Income |
| ---: | :--- |
| 17,580 | - Operating Expenses |
| 21,208 | - Mortgage Payments |
| 13,980 | $=$ Cash Flow |
| 104,700 | $/$ Downpayment + Closing Costs |
| $13.4 \%$ | $=$ Return on Investment from Cash Flow |

## 2 Appreciation

As the value of the property increases, your return on investment increases.
$349,000=$ Acquisiton Price
5\% * First Year Appreciation
$366,450=$ Value at the end of Year 1.
$17,450=$ Amount of Value Increase
104,700 / Downpayment + Closing Costs
$17 \%=$ Return on Investment from Appreciation

## 3 Equity Build-Up

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

| 261,750 | $=$ Loan Amount at Closing |
| ---: | :--- |
| 257,428 | $=$ Loan Amount at the end of Year 1 |
| 4,322 | - Equity Build-Up in Year 1 |
| 104,700 | $/$ Downpayment + Closing Costs |
| $4.1 \%$ | $=$ 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.

35,188 = Cash Flow Before Loan Payments (rents less expenses)
9,888 - Depreciation (assumes 15\% land, 30 year recovery)
16,887 - Mortgage Interest
$8,413=$ Taxable Income Year 1
6,731 Less 20\% Exclusion for LLC Ownership under new tax law
37\% * Marginal Tax Rate
$2,490.30=$ Federal Income Tax
2,490 Federal Income Tax
13,980 / Cash Flow
17.8\% = Effective Tax Rate on This Investment
$5,173=$ Tax if Cash Flow came from a non-preferred investment vehicle
2,490 - Tax from this preferred investment vehicle.
$2,682=$ Income Tax Savings
2.6\% Return on Investment from Tax Savings

Total / Summary
13,980 Cash Flow
17,450 Appreciation Year 1
4,322 Equity Build Up Year 1
2,682 Tax Savings Year 1
38,434 Total Return from this Investment
104,700 Downpayment + Closing Costs
36.7\% Total Return from this Investment

| IIIustration of Internal Rate of Return over a 10-Year Holding Period 2203 NORTH CHARLES STREET |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Purchase Price | 349,000 | $\underline{2024}$ | $\underline{2025}$ | $\underline{2026}$ | $\underline{2027}$ | $\underline{2028}$ | $\underline{2029}$ | $\underline{2030}$ | $\underline{2031}$ | $\underline{2032}$ | $\underline{2033}$ |
| Annual Rent | 7.0\% | 52,768 | 56,461 | 60,414 | 64,643 | 69,168 | 74,009 | 79,190 | 84,733 | 90,665 | 97,011 |
| Vacancy | 3.0\% | 1,583 | 1,694 | 1,812 | 1,939 | 2,075 | 2,220 | 2,376 | 2,542 | 2,720 | 2,910 |
| Effective Income |  | 51,185 | 54,768 | 58,601 | 62,703 | 67,093 | 71,789 | 76,814 | 82,191 | 87,945 | 94,101 |
| Expenses | 7.0\% | 17,580 | 18,810 | 20,127 | 21,536 | 23,043 | 24,656 | 26,382 | 28,229 | 30,205 | 32,320 |
| Exp as a percent of Annual Rent |  | 34\% | 34\% | 34\% | 34\% | 34\% | 34\% | 34\% | 34\% | 34\% | 34\% |
| Exp per unit | 4 | 4,395 | 4,703 | 5,032 | 5,384 | 5,761 | 6,164 | 6,596 | 7,057 | 7,551 | 8,080 |
| NOI | 0 | 33,605 | 35,957 | 38,474 | 41,168 | 44,049 | 47,133 | 50,432 | 53,962 | 57,740 | 61,781 |
| Debt Service | \$ 1,767 | 21,208 | 21,208 | 21,208 | 21,208 | 21,208 | 21,208 | 21,208 | 21,208 | 21,208 | 21,208 |
| Before Tax Cash Flow | $(104,700)$ | 12,397 | 14,749 | 17,266 | 19,959 | 22,841 | 25,924 | 29,224 | 32,754 | 36,531 | 410,656 |
| 26.2\% Internal Rate of Return |  |  |  |  |  |  |  |  |  |  |  |
| NOI |  | 33,605 | 35,957 | 38,474 | 41,168 | 44,049 | 47,133 | 50,432 | 53,962 | 57,740 | 61,781 |
| Less Interest |  | 16,887 | 16,597 | 16,288 | 15,959 | 15,607 | 15,232 | 14,832 | 14,405 | 13,949 | 13,463 |
| Less Depreciation |  | 9,307 | 9,307 | 9,307 | 9,307 | 9,307 | 9,307 | 9,307 | 9,307 | 9,307 | 9,307 |
| Taxable Income to Individuals |  | 7,412 | 10,054 | 12,879 | 15,902 | 19,135 | 22,594 | 26,294 | 30,251 | 34,484 | 39,012 |
| Pass Thru Entity | 20\% | $(1,482)$ | $(2,011)$ | $(2,576)$ | $(3,180)$ | $(3,827)$ | $(4,519)$ | $(5,259)$ | $(6,050)$ | $(6,897)$ | $(7,802)$ |
| Taxable Income | 0 | 5,929 | 8,043 | 10,304 | 12,722 | 15,308 | 18,075 | 21,035 | 24,201 | 27,587 | 31,209 |
| Tax @ * | 37\% | 2,194 | 2,976 | 3,812 | 4,707 | 5,664 | 6,688 | 7,783 | 8,954 | 10,207 | 11,547 |
| After Tax Cash Flow | $(104,700)$ | 10,203 | 11,773 | 13,454 | 15,252 | 17,177 | 19,237 | 21,441 | 23,800 | 26,324 | 335,701 |
| 21.8\% Internal Rate of Return |  |  |  |  |  |  |  |  |  |  |  |
| Purchase | 349,000 |  |  |  |  |  |  | Assume a Sale at End of Year 10 |  |  |  |
| L-V | 75\% |  |  |  |  |  |  | Annual Rent Roll |  |  | 97,011 |
| Loan | 261,750 |  |  |  |  |  |  | GRM |  |  | 6.3 |
| Down Payment | 87,250 |  |  |  | annual appreciation |  | 5.7\% | Price |  |  | 609,541 |
| Cap Improvement | - |  |  |  |  |  |  | Sale Costs |  | 6\% | 36,572 |
| Closing Costs | 17,450 |  |  |  |  |  |  | Less: Basis |  |  | 255,933 |
| Initial Investment | 104,700 |  |  |  |  |  |  | Gain |  |  | 317,035 |
| Rate | 6.50\% |  |  |  |  |  |  | Tax @ |  | 20\% | 63,407 |
| Term | 25 |  |  |  |  |  |  | Mortgage Balance |  |  | 202,886 |
| P\&I | \$1,767.35 |  |  |  |  |  |  | Sale Proceeds Before Tax |  |  | 370,083 |
|  |  |  |  |  |  |  |  | Sale Proceeds After Tax |  |  | 306,676 |
| Mortgage Amortization |  | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| 261,750 Beg Bal |  | 261,750 | 257,428 | 252,817 | 247,897 | 242,648 | 237,046 | 231,070 | 224,694 | 217,890 | 210,631 |
| 6.50\% Prin |  | 4,322 | 4,611 | 4,920 | 5,250 | 5,601 | 5,976 | 6,376 | 6,803 | 7,259 | 7,745 |
| 25.0 | Int | 16,887 | 16,597 | 16,288 | 15,959 | 15,607 | 15,232 | 14,832 | 14,405 | 13,949 | 13,463 |
|  | Bal EOY | 257,428 | 252,817 | 247,897 | 242,648 | 237,046 | 231,070 | 224,694 | 217,890 | 210,631 | 202,886 |
| Cost Recovery / Depreciation |  | 349,000 | 349,000 | Building | 80\% | 279,200 | Land | 20\% | 69,800 | Life | 30 |
|  |  | 9,307 | 9,307 | 9,307 | 9,307 | 9,307 | 9,307 | 9,307 | 9,307 | 9,307 | 9,307 |
| Basis |  | 339,693 | 330,387 | 321,080 | 311,773 | 302,467 | 293,160 | 283,853 | 274,547 | 265,240 | 255,933 |

