

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.

51,817	+	Rental Income
17,210	-	Operating Expenses
25,817	-	Mortgage Payments
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8,790	=	Cash Flow
126,150	/	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.

420,500	=	Acquisition Price
5%	*	First Year Appreciation
441,525	=	Value at the end of Year 1.
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21,025	=	Amount of Value Increase
126,150	/	Downpayment + Closing Costs
17%	=	Return on Investment from Appreciation

3 **Equity Build-Up**

7.25% 30 \$ 2,151.41

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

315,375	=	Loan Amount at Closing
312,323	=	Loan Amount at the end of Year 1
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3,052	-	Equity Build-Up in Year 1
126,150	/	Downpayment + Closing Costs
2.4%	=	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.

34,607	=	Cash Flow Before Loan Payments (rents less expenses)
11,914	-	Depreciation (assumes 15% land, 30 year recovery)
22,765	-	Mortgage Interest
(72)	=	Taxable Income Year 1
(57)	=	Less 20% Exclusion for LLC Ownership under new tax law
37%	*	Marginal Tax Rate
(21.20)	=	Federal Income Tax
(21)	=	Federal Income Tax
8,790	/	Cash Flow
-0.2%	=	Effective Tax Rate on This Investment
3,252	=	Tax if Cash Flow came from a non-preferred investment vehicle
(21)	-	Tax from this preferred investment vehicle.
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3,274	=	Income Tax Savings
2.6%	=	Return on Investment from Tax Savings

Total / Summary

1:	8,790	Cash Flow
2:	21,025	Appreciation Year 1
3:	3,052	Equity Build Up Year 1
4:	3,274	Tax Savings Year 1
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	36,141	Total Return from this Investment
	126,150	Downpayment + Closing Costs
	28.6%	Total Return from this Investment

Illustration of Internal Rate of Return over a 10-Year Holding Period
2822 GUILFORD AVENUE

Purchase Price	420,500	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Annual Rent	4.0%	51,817	53,890	56,046	58,288	60,619	63,044	65,566	68,188	70,916	73,752
Vacancy	3.0%	1,555	1,617	1,681	1,749	1,819	1,891	1,967	2,046	2,127	2,213
Effective Income		50,263	52,273	54,364	56,539	58,801	61,153	63,599	66,143	68,788	71,540
Expenses	4.0%	17,210	17,899	18,615	19,359	20,134	20,939	21,777	22,648	23,554	24,496
Exp as a percent of Annual Rent		34%	34%	34%	34%	34%	34%	34%	34%	34%	34%
Exp per unit	3	5,737	5,966	6,205	6,453	6,711	6,980	7,259	7,549	7,851	8,165
NOI	0	33,053	34,375	35,750	37,180	38,667	40,214	41,822	43,495	45,235	47,044
Debt Service	\$ 2,151	25,817	25,817	25,817	25,817	25,817	25,817	25,817	25,817	25,817	25,817
Before Tax Cash Flow	(126,150)	7,236	8,558	9,933	11,363	12,850	14,397	16,005	17,678	19,418	311,618
15.8% Internal Rate of Return											
NOI		33,053	34,375	35,750	37,180	38,667	40,214	41,822	43,495	45,235	47,044
Less Interest		22,765	22,536	22,290	22,025	21,741	21,436	21,107	20,754	20,375	19,967
Less Depreciation		11,213	11,213	11,213	11,213	11,213	11,213	11,213	11,213	11,213	11,213
Taxable Income to Individuals		(925)	626	2,247	3,941	5,712	7,564	9,501	11,527	13,647	15,864
Pass Thru Entity	20%	185	(125)	(449)	(788)	(1,142)	(1,513)	(1,900)	(2,305)	(2,729)	(3,173)
Taxable Income	0	(740)	500	1,797	3,153	4,570	6,052	7,601	9,222	10,917	12,691
Tax @ *	37%	(274)	185	665	1,167	1,691	2,239	2,812	3,412	4,039	4,696
After Tax Cash Flow	(126,150)	7,510	8,373	9,268	10,196	11,159	12,157	13,193	14,266	15,378	256,077
13.4% Internal Rate of Return											
Purchase	420,500							Assume a Sale at End of Year 10			
L-V	75%							Annual Rent Roll			73,752
Loan	315,375							GRM			8.1
Down Payment	105,125							Price			598,503
Cap Improvement	-							Sale Costs		6%	35,910
Closing Costs	21,025							Less: Basis			308,367
Initial Investment	126,150							Gain			254,226
Rate	7.25%							Tax @		20%	50,845
Term	30							Mortgage Balance			272,201
P&I	\$2,151.41							Sale Proceeds Before Tax			290,391
								Sale Proceeds After Tax			239,546
Mortgage Amortization		1	2	3	4	5	6	7	8	9	10
315,375 Beg Bal		315,375	312,323	309,041	305,514	301,723	297,647	293,266	288,556	283,494	278,051
7.25% Prin		3,052	3,281	3,527	3,792	4,076	4,381	4,710	5,063	5,442	5,850
30.0 Int		22,765	22,536	22,290	22,025	21,741	21,436	21,107	20,754	20,375	19,967
2,151 Bal EOY		312,323	309,041	305,514	301,723	297,647	293,266	288,556	283,494	278,051	272,201
Cost Recovery / Depreciation		420,500	420,500	Building	80%	336,400	Land	20%	84,100	Life	30
		11,213	11,213	11,213	11,213	11,213	11,213	11,213	11,213	11,213	11,213
Basis		409,287	398,073	386,860	375,647	364,433	353,220	342,007	330,793	319,580	308,367

* 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%.