

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.

102,930	+	Rental Income
40,035	-	Operating Expenses
45,273	-	Mortgage Payments
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17,622	=	Cash Flow
223,500	/	Downpayment + Closing Costs
7.9%	=	Return on Investment from Cash Flow

2 Appreciation

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

745,000	=	Acquisition Price
5%	*	First Year Appreciation
782,250	=	Value at the end of Year 1.
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37,250	=	Amount of Value Increase
223,500	/	Downpayment + Closing Costs
17%	=	Return on Investment from Appreciation

3 Equity Build-Up

6.50% 25 \$ 3,772.72

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

558,750	=	Loan Amount at Closing
549,524	=	Loan Amount at the end of Year 1
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9,226	-	Equity Build-Up in Year 1
223,500	/	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.

62,895	=	Cash Flow Before Loan Payments (rents less expenses)
21,108	-	Depreciation (assumes 15% land, 30 year recovery)
36,047	-	Mortgage Interest
5,739	=	Taxable Income Year 1
4,591		Less 20% Exclusion for LLC Ownership under new tax law
37%	*	Marginal Tax Rate
1,698.81	=	Federal Income Tax
1,699		Federal Income Tax
17,622	/	Cash Flow
9.6%	=	Effective Tax Rate on This Investment
6,520	=	Tax if Cash Flow came from a non-preferred investment vehicle
1,699	-	Tax from this preferred investment vehicle.
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4,821	=	Income Tax Savings
2.2%		Return on Investment from Tax Savings

Total / Summary

1:	17,622	Cash Flow
2:	37,250	Appreciation Year 1
3:	9,226	Equity Build Up Year 1
4:	4,821	Tax Savings Year 1
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	68,919	Total Return from this Investment
	223,500	Downpayment + Closing Costs
	30.8%	Total Return from this Investment

Illustration of Internal Rate of Return over a 10-Year Holding Period
2 6 5 3 M A R Y L A N D A V E N U E

Purchase Price	745,000	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Annual Rent	4.0%	102,930	107,047	111,329	115,782	120,413	125,230	130,239	135,449	140,867	146,501
Vacancy	3.0%	3,088	3,211	3,340	3,473	3,612	3,757	3,907	4,063	4,226	4,395
Effective Income		99,842	103,836	107,989	112,309	116,801	121,473	126,332	131,385	136,641	142,106
Expenses	4.0%	40,035	41,637	43,302	45,034	46,835	48,709	50,657	52,683	54,791	56,982
Exp as a percent of Annual Rent	40%	40%	40%	40%	40%	40%	40%	40%	40%	40%	40%
Exp per unit	8	5,004	5,205	5,413	5,629	5,854	6,089	6,332	6,585	6,849	7,123
NOI	0	59,807	62,199	64,687	67,275	69,965	72,764	75,675	78,702	81,850	85,124
Debt Service	\$ 3,773	45,273	45,273	45,273	45,273	45,273	45,273	45,273	45,273	45,273	45,273
Before Tax Cash Flow	(223,500)	14,534	16,926	19,414	22,002	24,693	27,491	30,402	33,429	36,577	618,527
17.3% Internal Rate of Return											

NOI		59,807	62,199	64,687	67,275	69,965	72,764	75,675	78,702	81,850	85,124
Less Interest		36,047	35,429	34,770	34,067	33,316	32,515	31,661	30,749	29,777	28,739
Less Depreciation		19,867	19,867	19,867	19,867	19,867	19,867	19,867	19,867	19,867	19,867
Taxable Income to Individuals		3,893	6,903	10,050	13,341	16,783	20,382	24,147	28,086	32,206	36,518
Pass Thru Entity	20%	(779)	(1,381)	(2,010)	(2,668)	(3,357)	(4,076)	(4,829)	(5,617)	(6,441)	(7,304)
Taxable Income	0	3,114	5,523	8,040	10,673	13,426	16,306	19,318	22,468	25,765	29,214
Tax @ *	37%	1,152	2,043	2,975	3,949	4,968	6,033	7,147	8,313	9,533	10,809
After Tax Cash Flow	(223,500)	13,382	14,883	16,439	18,053	19,725	21,458	23,255	25,116	27,044	514,631
14.4% Internal Rate of Return											

Purchase	745,000										Assume a Sale at End of Year 10
L-V	75%										Annual Rent Roll
Loan	558,750										146,501
Down Payment	186,250										GRM
Cap Improvement	-										7.3
Closing Costs	37,250										Price
Initial Investment	223,500										annual appreciation
Rate	6.50%										3.7%
Term	25										6%
P&I	\$3,772.72										64,581
											Sale Costs
											Less: Basis
											546,333
											Gain
											465,438
											Tax @
											20%
											93,088
											Mortgage Balance
											433,095
											Sale Proceeds Before Tax
											578,676
											Sale Proceeds After Tax
											485,589

Mortgage Amortization		1	2	3	4	5	6	7	8	9	10
558,750 Beg Bal		558,750	549,524	539,681	529,179	517,973	506,016	493,259	479,647	465,124	449,628
6.50% Prin		9,226	9,843	10,503	11,206	11,956	12,757	13,612	14,523	15,496	16,534
25.0 Int		36,047	35,429	34,770	34,067	33,316	32,515	31,661	30,749	29,777	28,739
3,773 Bal EOY		549,524	539,681	529,179	517,973	506,016	493,259	479,647	465,124	449,628	433,095
Cost Recovery / Depreciation		745,000	745,000	Building	80%	596,000	Land	20%	149,000	Life	30
Basis		19,867	19,867	19,867	19,867	19,867	19,867	19,867	19,867	19,867	19,867
		725,133	705,267	685,400	665,533	645,667	625,800	605,933	586,067	566,200	546,333

* 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%.