## 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.

| 60,859 | + Rental Income |
| :---: | :--- |
| 12,587 | - Operating Expenses |
| 32,932 | - Mortgage Payments |
| 15,340 | $=$ Cash Flow |
| 165,000 | $/$ Downpayment + Closing Costs |
| $9.3 \%$ | $=$ Return on Investment from Cash Flow |

## 2 Appreciation

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

| 550,000 | $=$ Acquisiton Price |
| ---: | :--- |
| $5 \%$ | $*$ First Year Appreciation |
| 577,500 | $=$ Value at the end of Year 1. |
| 27,500 | $=$ Amount of Value Increase |
| 165,000 | $/$ 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.
$412,500=$ Loan Amount at Closing

| $408,310=$ Loan Amount at the end of Year 1 |
| ---: |
| $4,190-$ Equity Build-Up in Year 1 |

165,000 / Downpayment + Closing Costs
2.5\% = 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.
48,272 = Cash Flow Before Loan Payments (rents less expenses)
15,583 - Depreciation (assumes 15\% land, 30 year recovery)
28,742 - Mortgage Interest
$3,947=$ Taxable Income Year 1
3,157 Less 20\% Exclusion for LLC Ownership under new tax law
37\% * Marginal Tax Rate
1,168.17 = Federal Income Tax
1,168 Federal Income Tax
15,340 / Cash Flow
7.6\% = Effective Tax Rate on This Investment
$5,676=$ Tax if Cash Flow came from a non-preferred investment vehicle
1,168 - Tax from this preferred investment vehicle.
4,507 = Income Tax Savings
2.7\% Return on Investment from Tax Savings

Total / Summary

| 1: | 15,340 | Cash Flow |
| ---: | ---: | :--- |
| 2: | 27,500 | Appreciation Year 1 |
| 3: | 4,190 | Equity Build Up Year 1 |
| 4: | 4,507 | Tax Savings Year 1 |
|  | 51,537 | Total Return from this Investment |
|  | 165,000 | Downpayment + Closing Costs |
|  | $31.2 \%$ | Total Return from this Investment |


| IIIustration of Internal Rate of Return over a 10-Year Holding Period 546 SAINTMARYSTREET |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Purchase Price | 550,000 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2031 | 2032 | 2033 | 2034 |
| Annual Rent | 5.0\% | 60,859 | 63,902 | 67,097 | 70,452 | 73,975 | 77,673 | 81,557 | 85,635 | 89,917 | 94,413 |
| Vacancy | 3.0\% | 1,826 | 1,917 | 2,013 | 2,114 | 2,219 | 2,330 | 2,447 | 2,569 | 2,698 | 2,832 |
| Effective Income |  | 59,033 | 61,985 | 65,084 | 68,339 | 71,755 | 75,343 | 79,110 | 83,066 | 87,219 | 91,580 |
| Expenses | 6.0\% | 12,587 | 13,342 | 14,143 | 14,991 | 15,891 | 16,844 | 17,855 | 18,926 | 20,062 | 21,266 |
| Exp as a percent of Annual Rent |  | 21\% | 22\% | 22\% | 22\% | 22\% | 22\% | 23\% | 23\% | 23\% | 23\% |
| Exp per unit | 3 | 4,196 | 4,447 | 4,714 | 4,997 | 5,297 | 5,615 | 5,952 | 6,309 | 6,687 | 7,089 |
| NOI | 0 | 46,446 | 48,643 | 50,942 | 53,347 | 55,865 | 58,499 | 61,255 | 64,140 | 67,157 | 70,315 |
| Debt Service | \$ 2,744 | 32,932 | 32,932 | 32,932 | 32,932 | 32,932 | 32,932 | 32,932 | 32,932 | 32,932 | 32,932 |
| Before Tax Cash Flow $19.5 \%$ | $(165,000)$ Internal Rate of | $13,514$ | 15,710 | 18,009 | 20,415 | 22,932 | 25,566 | 28,323 | 31,207 | 34,225 | 485,443 |
| NOI |  | 46,446 | 48,643 | 50,942 | 53,347 | 55,865 | 58,499 | 61,255 | 64,140 | 67,157 | 70,315 |
| Less Interest |  | 28,742 | 28,439 | 28,115 | 27,766 | 27,393 | 26,992 | 26,563 | 26,102 | 25,609 | 25,079 |
| Less Depreciation |  | 14,667 | 14,667 | 14,667 | 14,667 | 14,667 | 14,667 | 14,667 | 14,667 | 14,667 | 14,667 |
| Taxable Income to Individuals |  | 3,037 | 5,537 | 8,160 | 10,914 | 13,805 | 16,840 | 20,026 | 23,371 | 26,882 | 30,569 |
| Pass Thru Entity | 20\% | (607) | $(1,107)$ | $(1,632)$ | $(2,183)$ | $(2,761)$ | $(3,368)$ | $(4,005)$ | $(4,674)$ | $(5,376)$ | $(6,114)$ |
| Taxable Income | 0 | 2,430 | 4,429 | 6,528 | 8,731 | 11,044 | 13,472 | 16,021 | 18,696 | 21,506 | 24,455 |
| Tax @ * | 37\% | 899 | 1,639 | 2,415 | 3,231 | 4,086 | 4,985 | 5,928 | 6,918 | 7,957 | 9,048 |
| After Tax Cash Flow $16.5 \%$ | 16.5\% Internal Rate of Return |  |  |  |  |  |  |  |  |  |  |
| Purchase | 550,000 |  |  |  |  |  |  | Assume a Sa | End of Y | ear 10 |  |
| L-V | 75\% |  |  |  |  |  |  | Annual Rent R |  |  | 94,413 |
| Loan | 412,500 |  |  |  |  |  |  | GRM |  |  | 9.0 |
| Down Payment | 137,500 |  |  |  | annua | preciation | 4.5\% | Price |  |  | 853,231 |
| Cap Improvement | - |  |  |  |  |  |  | Sale Costs |  | 6\% | 51,194 |
| Closing Costs | 27,500 |  |  |  |  |  |  | Less: Basis |  |  | 403,333 |
| Initial Investment | 165,000 |  |  |  |  |  |  | Gain |  |  | 398,703 |
| Rate | 7.00\% |  |  |  |  |  |  | Tax @ |  | 20\% | 79,741 |
| Term | 30 |  |  |  |  |  |  | Mortgage Balance |  |  | 353,976 |
| P\&I | \$2,744.37 |  |  |  |  |  |  | Sale Proceeds Before Tax |  |  | 448,061 |
|  |  |  |  |  |  |  |  | Sale Proceeds After Tax |  |  | 368,320 |
| Mortgage Amortization |  | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| 412,500 | Beg Bal | 412,500 | 408,310 | 403,817 | 398,999 | 393,832 | 388,293 | 382,353 | 375,983 | 369,153 | 361,829 |
| 7.00\% | Prin | 4,190 | 4,493 | 4,818 | 5,166 | 5,540 | 5,940 | 6,370 | 6,830 | 7,324 | 7,853 |
| 30.0 | Int | 28,742 | 28,439 | 28,115 | 27,766 | 27,393 | 26,992 | 26,563 | 26,102 | 25,609 | 25,079 |
| 2,744 | Bal EOY | 408,310 | 403,817 | 398,999 | 393,832 | 388,293 | 382,353 | 375,983 | 369,153 | 361,829 | 353,976 |
| Cost Recovery / Depreciation |  | 550,000 | 550,000 | Building | 80\% | 440,000 | Land | 20\% | 110,000 | Life | 30 |
|  |  | 14,667 | 14,667 | 14,667 | 14,667 | 14,667 | 14,667 | 14,667 | 14,667 | 14,667 | 14,667 |
| Basis |  | 535,333 | 520,667 | 506,000 | 491,333 | 476,667 | 462,000 | 447,333 | 432,667 | 418,000 | 403,333 |
| ${ }^{*}$ 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 $\$ 500 \mathrm{k} / \$ 600 \mathrm{k}$ is $37 \%$. |  |  |  |  |  |  |  |  |  |  |  |

