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 7.00% 30 \$ 2,744.37

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.

| Sumont voin | 0103 | • |
|-----------------|------|---|
| 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 |

| | | | Illustration of | f Internal Rate | of Poturn ove | or a 10-Voar H | oldina Period | | | | |
|----------------------------|----------------------------------|------------------------|-----------------|-----------------|---------------|-----------------|----------------|-------------------------|----------------|---------|---------|
| | | | mustration of | 546 SAIN | | | olallig Period | | | | |
| 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 Annu | ual 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 Re | 13,514 eturn | 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 Indivi | duals | 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) | | (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 | (165,000) | 12,615 | 14,071 | 15,594 | 17,184 | 18,846 | 20,582 | 22,395 | 24,289 | 26,268 | 396,654 |
| | Internal Rate of Re | | | | | | | | | | |
| Purchase | 550,000 | Starri | | | | | | Assume a Sa | le at End of Y | ear 10 | |
| L-V | 75% | | | | | | | Annual Rent F | | | 94,413 |
| Loan | 412,500 | | | | | | | GRM | | | 9.0 |
| Down Payment | 137,500 | | | | annua | al appreciation | 4.5% | | | | 853,231 |
| Cap Improvement | - | | | | | | | Sale Costs | | 6% | 51,194 |
| Closing Costs | 27,500 | | | | | | | Less: Basis | | 0,0 | 403,333 |
| Initial Investment | 165,000 | | | | | | | Gain | | | 398,703 |
| Rate | 7.00% | + | | | | | | Tax @ | | 20% | 79,741 |
| Term | 30 | | | | | | | Mortgage Bala | ance | | 353,976 |
| P&I | \$2,744.37 | | | | | | | Sale Proceeds | | | 448,061 |
| | | | | | | | | Sale Proceeds After Tax | | | 368,320 |
| Mortgage Amortization | | 1 | 2 | 3 | 4 | 5 | 6 | | | 9 | 10 |
| 412,500 | | 412,500 | 408,310 | 403,817 | 398,999 | 393,832 | 388,293 | 382,353 | 375,983 | 369,153 | 361,829 |
| 7.00% | | 4,190 | 4,493 | 4,818 | 5,166 | 5,540 | 5,940 | 6,370 | 6,830 | 7,324 | 7,853 |
| 30.0 | | 28,742 | 28,439 | 28,115 | 27,766 | 27,393 | 26,992 | 26,563 | 26,102 | 25,609 | 25,079 |
| | Bal EOY | 408,310 | 403,817 | 398,999 | 393,832 | 388,293 | 382,353 | 375,983 | 369,153 | 361,829 | 353,976 |
| Cost Recovery / Deprec | | 550,000 | 550,000 | | 80% | 440,000 | | 20% | 110,000 | | 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 | s to income of \$200 | | | | · · | · | | | | | , |

