

## 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.

41,568	+	Rental Income
14,065	-	Operating Expenses
21,610	-	Mortgage Payments
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5,893	=	Cash Flow
112,500	/	Downpayment + Closing Costs
5.2%	=	Return on Investment from Cash Flow

### 2 **Appreciation**

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

375,000	=	Acquisition Price
5%	*	First Year Appreciation
393,750	=	Value at the end of Year 1.
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18,750	=	Amount of Value Increase
112,500	/	Downpayment + Closing Costs
17%	=	Return on Investment from Appreciation

### 3 **Equity Build-Up**      6.63%      30 \$      1,800.87

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

281,250	=	Loan Amount at Closing
278,180	=	Loan Amount at the end of Year 1
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3,070	-	Equity Build-Up in Year 1
112,500	/	Downpayment + Closing Costs
2.7%	=	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.

27,503	=	Cash Flow Before Loan Payments (rents less expenses)
11,591	-	Depreciation (assumes 15% land, 27.5 year recovery)
18,541	-	Mortgage Interest
(2,628)	=	Taxable Income Year 1
33%	*	Marginal Tax Rate
(867)	=	Federal Income Tax
(867)		Federal Income Tax
5,893	/	Cash Flow
-14.7%	=	Effective Tax Rate on This Investment
1,945	=	Tax if Cash Flow came from a non-preferred investment vehicle
(867)	-	Tax from this preferred investment vehicle.
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2,812	=	Income Tax Savings
2.5%	=	Return on Investment from Tax Savings

### **Total / Summary**

1:	5,893	Cash Flow
2:	18,750	Appreciation Year 1
3:	3,070	Equity Build Up Year 1
4:	2,812	Tax Savings Year 1
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	30,524	Total Return from this Investment
	112,500	Downpayment + Closing Costs

27.1% Total Return from this Investment

**Illustration of Internal Rate of Return over a 10-Year Holding Period  
664 PORTLAND STREET**

Purchase Price	375,000	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Annual Rent	4.0%	41,568	43,231	44,960	46,758	48,629	50,574	52,597	54,701	56,889	59,164
Expenses	4.0%	14,065	14,627	15,212	15,821	16,454	17,112	17,796	18,508	19,249	20,019
Exp as a percent of Annual Rent		34%	34%	34%	34%	34%	34%	34%	34%	34%	34%
Exp per unit	2	7,032	7,314	7,606	7,910	8,227	8,556	8,898	9,254	9,624	10,009
NOI	0	27,503	28,603	29,747	30,937	32,175	33,462	34,800	36,192	37,640	39,146
Debt Service	\$ 1,801	21,610	21,610	21,610	21,610	21,610	21,610	21,610	21,610	21,610	21,610
<b>Before Tax Cash Flow</b>	<b>(112,500)</b>	<b>5,893</b>	<b>6,993</b>	<b>8,137</b>	<b>9,327</b>	<b>10,564</b>	<b>11,851</b>	<b>13,190</b>	<b>14,582</b>	<b>16,030</b>	<b>280,077</b>
<b>15.3% Internal Rate of Return</b>											
NOI		27,503	28,603	29,747	30,937	32,175	33,462	34,800	36,192	37,640	39,146
Less Interest		18,541	18,331	18,107	17,868	17,612	17,339	17,047	16,736	16,403	16,047
Less Depreciation		10,909	10,909	10,909	10,909	10,909	10,909	10,909	10,909	10,909	10,909
Taxable Income	0	(1,947)	(637)	731	2,160	3,654	5,214	6,844	8,548	10,328	12,189
Tax @	25%	(487)	(159)	183	540	913	1,303	1,711	2,137	2,582	3,047
<b>After Tax Cash Flow</b>	<b>(112,500)</b>	<b>6,379</b>	<b>7,152</b>	<b>7,954</b>	<b>8,787</b>	<b>9,651</b>	<b>10,548</b>	<b>11,479</b>	<b>12,445</b>	<b>13,447</b>	<b>229,868</b>
<b>13.2% Internal Rate of Return</b>											
Purchase	375,000								<b>Assume a Sale at End of Year 10</b>		
L-V	75%								Annual Rent Roll		59,164
Loan	281,250								GRM		9.0
Down Payment	93,750						annual appreciation	3.6%	Price		533,742
Cap Improvement	-								Sale Costs	6%	32,025
Closing Costs	18,750								Less: Basis		265,909
Initial Investment	112,500								Gain		235,808
Rate	6.63%								Tax @	20%	47,162
Term	30								Mortgage Balance		239,176
P&I	\$1,800.87								Sale Proceeds Before Tax		262,542
									Sale Proceeds After Tax		215,380
<b>Mortgage Amortization</b>		1	2	3	4	5	6	7	8	9	10
281,250	Beg Bal	281,250	278,180	274,901	271,397	267,655	263,656	259,385	254,822	249,947	244,739
6.63%	Prin	3,070	3,279	3,503	3,743	3,998	4,271	4,563	4,875	5,208	5,563
30.0	Int	18,541	18,331	18,107	17,868	17,612	17,339	17,047	16,736	16,403	16,047
1,801	Bal EOY	278,180	274,901	271,397	267,655	263,656	259,385	254,822	249,947	244,739	239,176
<b>Cost Recovery / Depreciation</b>		375,000	375,000	Building	80%	300,000	Land	20%	75,000	Life	27.5
		10,909	10,909	10,909	10,909	10,909	10,909	10,909	10,909	10,909	10,909
Basis		364,091	353,182	342,273	331,364	320,455	309,545	298,636	287,727	276,818	265,909