## 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.

59,784 + Rental Income
17,133 - Operating Expenses
29,678 - Mortgage Payments
$12,972=$ Cash Flow
154,500 / Downpayment + Closing Costs
8.4\% = Return on Investment from Cash Flow

## 2 Appreciation

As the value of the property increases, your return on investment increases.
$515,000=$ Acquisiton Price
5\% * First Year Appreciation
$540,750=$ Value at the end of Year 1.
$25,750=$ Amount of Value Increase
154,500 / 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.

386,250 = Loan Amount at Closing
$382,034=$ Loan Amount at the end of Year 1
4,216 - Equity Build-Up in Year 1
154,500 / 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.

| 42,651 | $=$ Cash Flow Before Loan Payments (rents less expenses) |
| ---: | :--- |
| 14,592 | - Depreciation (assumes 15\% land, 30 year recovery) |
| 25,463 | - Mortgage Interest |
| 2,597 | $=$ Taxable Income Year 1 |
| 2,077 |  |
| $37 \%$ | Less 20\% Exclusion for LLC Ownership under new tax law |
| 768.60 | $=$ Federal Income Tax |
| 769 |  |
| Federal Income Tax |  |
| 12,972 | $/$ Cash Flow |
| $5.9 \%$ | $=$ Effective Tax Rate on This Investment |
| 4,800 | $=$ Tax if Cash Flow came from a non-preferred investment vehicle |
| 769 | - Tax from this preferred investment vehicle. |
| 4,031 | $=$ |

Total / Summary
12,972 Cash Flow
25,750 Appreciation Year 1
4,216 Equity Build Up Year 1
4,031 Tax Savings Year 1
46,970 Total Return from this Investment
154,500 Downpayment + Closing Costs
30.4\% Total Return from this Investment

| IIlustration of Internal Rate of Return over a 10-Year Holding Period 2511 NORTH CHARLES STREET |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Purchase Price | 515,000 | $\underline{2024}$ | $\underline{2025}$ | $\underline{2026}$ | $\underline{2027}$ | 2028 | 2029 | $\underline{2030}$ | $\underline{2031}$ | 2032 | $\underline{2033}$ |
| Annual Rent | 4.0\% | 59,784 | 62,175 | 64,662 | 67,249 | 69,939 | 72,736 | 75,646 | 78,672 | 81,819 | 85,091 |
| Vacancy | 3.0\% | 1,794 | 1,865 | 1,940 | 2,017 | 2,098 | 2,182 | 2,269 | 2,360 | 2,455 | 2,553 |
| Effective Income |  | 57,990 | 60,310 | 62,723 | 65,231 | 67,841 | 70,554 | 73,376 | 76,312 | 79,364 | 82,539 |
| Expenses | 4.0\% | 17,133 | 17,818 | 18,531 | 19,272 | 20,043 | 20,845 | 21,679 | 22,546 | 23,448 | 24,386 |
| Exp as a percent of Annual Rent |  | 30\% | 30\% | 30\% | 30\% | 30\% | 30\% | 30\% | 30\% | 30\% | 30\% |
| Exp per unit | 4 | 4,283 | 4,455 | 4,633 | 4,818 | 5,011 | 5,211 | 5,420 | 5,637 | 5,862 | 6,096 |
| NOI | 0 | 40,857 | 42,492 | 44,191 | 45,959 | 47,797 | 49,709 | 51,698 | 53,765 | 55,916 | 58,153 |
| Debt Service | \$ 2,473 | 29,678 | 29,678 | 29,678 | 29,678 | 29,678 | 29,678 | 29,678 | 29,678 | 29,678 | 29,678 |
| Before Tax Cash Flow | $(154,500)$ | 11,179 | 12,813 | 14,513 | 16,281 | 18,119 | 20,031 | 22,019 | 24,087 | 26,238 | 389,032 |
| 17.0\% Internal Rate of Return |  |  |  |  |  |  |  |  |  |  |  |
| NOI |  | 40,857 | 42,492 | 44,191 | 45,959 | 47,797 | 49,709 | 51,698 | 53,765 | 55,916 | 58,153 |
| Less Interest |  | 25,463 | 25,175 | 24,867 | 24,538 | 24,187 | 23,812 | 23,412 | 22,984 | 22,526 | 22,038 |
| Less Depreciation |  | 13,733 | 13,733 | 13,733 | 13,733 | 13,733 | 13,733 | 13,733 | 13,733 | 13,733 | 13,733 |
| Taxable Income to Individuals |  | 1,661 | 3,584 | 5,591 | 7,687 | 9,877 | 12,164 | 14,553 | 17,048 | 19,656 | 22,381 |
| Pass Thru Entity | 20\% | (332) | (717) | $(1,118)$ | $(1,537)$ | $(1,975)$ | $(2,433)$ | $(2,911)$ | $(3,410)$ | $(3,931)$ | $(4,476)$ |
| Taxable Income | 0 | 1,329 | 2,867 | 4,473 | 6,150 | 7,901 | 9,731 | 11,642 | 13,639 | 15,725 | 17,905 |
| Tax @ * | 37\% | 492 | 1,061 | 1,655 | 2,275 | 2,923 | 3,600 | 4,308 | 5,046 | 5,818 | 6,625 |
| After Tax Cash Flow | $(154,500)$ | 10,687 | 11,752 | 12,858 | 14,005 | 15,195 | 16,430 | 17,712 | 19,041 | 20,419 | 320,135 |
| 14.3\% Internal Rate of Return |  |  |  |  |  |  |  |  |  |  |  |
| Purchase | 515,000 |  |  |  |  |  |  | Assume a Sale at End of Year 10 |  |  |  |
| L-V | 75\% |  |  |  |  |  |  | Annual Rent Roll |  |  | 85,091 |
| Loan | 386,250 |  |  |  |  |  |  | GRM |  |  | 8.6 |
| Down Payment | 128,750 |  |  |  | annual appreciation |  | 3.6\% | Price |  |  | 733,006 |
| Cap Improvement | - |  |  |  |  |  |  | Sale Costs |  | 6\% | 43,980 |
| Closing Costs | 25,750 |  |  |  |  |  |  | Less: Basis |  |  | 377,667 |
| Initial Investment | 154,500 |  |  |  |  |  |  | Gain |  |  | 311,359 |
| Rate | 6.63\% |  |  |  |  |  |  | Tax @ |  | 20\% | 62,272 |
| Term | 30 |  |  |  |  |  |  | Mortgage Balance |  |  | 328,468 |
| P\&I | \$2,473.20 |  |  |  |  |  |  | Sale Proceeds Before Tax |  |  | 360,557 |
|  |  |  |  |  |  |  |  | Sale Proceeds After Tax |  |  | 298,286 |
| Mortgage Amortization |  | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| 386,250 Beg Bal |  | 386,250 | 382,034 | 377,530 | 372,719 | 367,579 | 362,088 | 356,222 | 349,955 | 343,260 | 336,108 |
| 6.63\% Prin |  | 4,216 | 4,504 | 4,811 | 5,140 | 5,491 | 5,866 | 6,267 | 6,695 | 7,152 | 7,640 |
| 30.02,473 | Int | 25,463 | 25,175 | 24,867 | 24,538 | 24,187 | 23,812 | 23,412 | 22,984 | 22,526 | 22,038 |
|  | Bal EOY | 382,034 | 377,530 | 372,719 | 367,579 | 362,088 | 356,222 | 349,955 | 343,260 | 336,108 | 328,468 |
| Cost Recovery / Depreciation |  | 515,000 | 515,000 | Building | 80\% | 412,000 | Land | 20\% | 103,000 | Life | 30 |
|  |  | 13,733 | 13,733 | 13,733 | 13,733 | 13,733 | 13,733 | 13,733 | 13,733 | 13,733 | 13,733 |
| Basis |  | 501,267 | 487,533 | 473,800 | 460,067 | 446,333 | 432,600 | 418,867 | 405,133 | 391,400 | 377,667 |
| * 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 $37 \%$. |  |  |  |  |  |  |  |  |  |  |  |

