

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.

71,880	+	Rental Income
14,444	-	Operating Expenses
42,665	-	Mortgage Payments
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14,771	=	Cash Flow
225,000	/	Downpayment + Closing Costs
6.6%	=	Return on Investment from Cash Flow

2 **Appreciation**

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

750,000	=	Acquisition Price
5%	*	First Year Appreciation
787,500	=	Value at the end of Year 1.
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37,500	=	Amount of Value Increase
225,000	/	Downpayment + Closing Costs
17%	=	Return on Investment from Appreciation

3 **Equity Build-Up** 6.50% 30 \$ 3,555.38

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

562,500	=	Loan Amount at Closing
556,213	=	Loan Amount at the end of Year 1
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6,287	-	Equity Build-Up in Year 1
225,000	/	Downpayment + Closing Costs
2.8%	=	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.

57,436	=	Cash Flow Before Loan Payments (rents less expenses)
23,182	-	Depreciation (assumes 15% land, 27.5 year recovery)
36,377	-	Mortgage Interest
(2,123)	=	Taxable Income Year 1
33%	*	Marginal Tax Rate
(701)	=	Federal Income Tax
(701)		Federal Income Tax
14,771	/	Cash Flow
-4.7%	=	Effective Tax Rate on This Investment
4,874	=	Tax if Cash Flow came from a non-preferred investment vehicle
(701)	-	Tax from this preferred investment vehicle.
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5,575	=	Income Tax Savings
2.5%	=	Return on Investment from Tax Savings

Total / Summary

1:	14,771	Cash Flow
2:	37,500	Appreciation Year 1
3:	6,287	Equity Build Up Year 1
4:	5,575	Tax Savings Year 1
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	64,134	Total Return from this Investment
	225,000	Downpayment + Closing Costs
	28.5%	Total Return from this Investment