

## 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.

87,552	+	Rental Income
30,103	-	Operating Expenses
34,986	-	Mortgage Payments
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22,463	=	Cash Flow
165,000	/	Downpayment + Closing Costs
13.6%	=	Return on Investment from Cash Flow

### 2 **Appreciation**

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

550,000	=	Acquisition Price
5%	*	First Year Appreciation
577,500	=	Value at the end of Year 1.
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27,500	=	Amount of Value Increase
165,000	/	Downpayment + Closing Costs
17%	=	Return on Investment from Appreciation

### 3 **Equity Build-Up**

7.00%      25 \$      2,915.46

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

412,500	=	Loan Amount at Closing
406,190	=	Loan Amount at the end of Year 1
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6,310	-	Equity Build-Up in Year 1
165,000	/	Downpayment + Closing Costs
3.8%	=	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.

57,449	=	Cash Flow Before Loan Payments (rents less expenses)
15,583	-	Depreciation (assumes 15% land, 30 year recovery)
28,675	-	Mortgage Interest
13,190	=	Taxable Income Year 1
10,552		Less 20% Exclusion for LLC Ownership under new tax law
37%	*	Marginal Tax Rate
3,904.34	=	Federal Income Tax
3,904		Federal Income Tax
22,463	/	Cash Flow
17.4%	=	Effective Tax Rate on This Investment
8,311	=	Tax if Cash Flow came from a non-preferred investment vehicle
3,904	-	Tax from this preferred investment vehicle.
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4,407	=	Income Tax Savings
2.7%	=	Return on Investment from Tax Savings

### **Total / Summary**

1:	22,463	Cash Flow
2:	27,500	Appreciation Year 1
3:	6,310	Equity Build Up Year 1
4:	4,407	Tax Savings Year 1
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	60,681	Total Return from this Investment
	165,000	Downpayment + Closing Costs
	36.8%	Total Return from this Investment

**Illustration of Internal Rate of Return over a 10-Year Holding Period  
4008 PRIMROSE AVENUE**

Purchase Price	550,000	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Annual Rent	4.0%	92,160	95,846	99,680	103,667	107,814	112,127	116,612	121,276	126,127	131,172
Vacancy	4.0%	3,686	3,834	3,987	4,147	4,313	4,485	4,664	4,851	5,045	5,247
Effective Income		88,474	92,013	95,693	99,521	103,502	107,642	111,947	116,425	121,082	125,926
Expenses	7.0%	30,103	32,210	34,465	36,878	39,459	42,221	45,177	48,339	51,723	55,344
Exp as a percent of Annual Rent		34%	35%	36%	37%	38%	39%	40%	42%	43%	44%
Exp per unit	8	3,763	4,026	4,308	4,610	4,932	5,278	5,647	6,042	6,465	6,918
NOI	0	58,370	59,802	61,228	62,643	64,042	65,420	66,770	68,086	69,359	70,582
Debt Service	\$ 2,915	34,986	34,986	34,986	34,986	34,986	34,986	34,986	34,986	34,986	34,986
<b>Before Tax Cash Flow</b>	<b>(165,000)</b>	<b>23,385</b>	<b>24,817</b>	<b>26,242</b>	<b>27,657</b>	<b>29,057</b>	<b>30,435</b>	<b>31,785</b>	<b>33,100</b>	<b>34,374</b>	<b>447,086</b>
<b>21.9% Internal Rate of Return</b>											
NOI		58,370	59,802	61,228	62,643	64,042	65,420	66,770	68,086	69,359	70,582
Less Interest		28,675	28,219	27,730	27,205	26,643	26,040	25,393	24,700	23,956	23,159
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		15,029	16,917	18,831	20,771	22,733	24,714	26,711	28,720	30,737	32,757
Pass Thru Entity	20%	(3,006)	(3,383)	(3,766)	(4,154)	(4,547)	(4,943)	(5,342)	(5,744)	(6,147)	(6,551)
Taxable Income	0	12,023	13,533	15,065	16,617	18,186	19,771	21,369	22,976	24,589	26,205
Tax @ *	37%	4,448	5,007	5,574	6,148	6,729	7,315	7,906	8,501	9,098	9,696
<b>After Tax Cash Flow</b>	<b>(165,000)</b>	<b>18,936</b>	<b>19,809</b>	<b>20,668</b>	<b>21,509</b>	<b>22,328</b>	<b>23,119</b>	<b>23,879</b>	<b>24,599</b>	<b>25,276</b>	<b>370,886</b>
<b>17.8% Internal Rate of Return</b>											
Purchase	550,000								<b>Assume a Sale at End of Year 10</b>		
L-V	75%								Annual Rent Roll		131,172
Loan	412,500								GRM		6.0
Down Payment	137,500							annual appreciation	3.6%	Price	782,821
Cap Improvement	-								Sale Costs	6%	46,969
Closing Costs	27,500								Less: Basis		403,333
Initial Investment	165,000								Gain		332,519
Rate	7.00%								Tax @	20%	66,504
Term	25								Mortgage Balance		324,363
P&I	\$2,915.46								Sale Proceeds Before Tax		411,489
									Sale Proceeds After Tax		344,986
<b>Mortgage Amortization</b>		1	2	3	4	5	6	7	8	9	10
412,500	Beg Bal	412,500	406,190	399,423	392,167	384,387	376,044	367,098	357,505	347,219	336,190
7.00%	Prin	6,310	6,767	7,256	7,780	8,343	8,946	9,593	10,286	11,030	11,827
25.0	Int	28,675	28,219	27,730	27,205	26,643	26,040	25,393	24,700	23,956	23,159
2,915	Bal EOY	406,190	399,423	392,167	384,387	376,044	367,098	357,505	347,219	336,190	324,363
<b>Cost Recovery / Depreciation</b>		550,000	550,000	Building	80%	440,000	Land	20%	110,000	Life	<b>30</b>
		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 \$500k/\$600k is 37%.