

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.

67,639	+	Rental Income
16,409	-	Operating Expenses
35,779	-	Mortgage Payments
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15,451	=	Cash Flow
165,000	/	Downpayment + Closing Costs
9.4%	=	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**

7.25% 25 \$ 2,981.58

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

412,500	=	Loan Amount at Closing
406,428	=	Loan Amount at the end of Year 1
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6,072	-	Equity Build-Up in Year 1
165,000	/	Downpayment + Closing Costs
3.7%	=	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.

51,230	=	Cash Flow Before Loan Payments (rents less expenses)
15,583	-	Depreciation (assumes 15% land, 30 year recovery)
29,707	-	Mortgage Interest
5,940	=	Taxable Income Year 1
4,752		Less 20% Exclusion for LLC Ownership under new tax law
37%	*	Marginal Tax Rate
1,758.17	=	Federal Income Tax
1,758		Federal Income Tax
15,451	/	Cash Flow
11.4%	=	Effective Tax Rate on This Investment
5,717	=	Tax if Cash Flow came from a non-preferred investment vehicle
1,758	-	Tax from this preferred investment vehicle.
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3,959	=	Income Tax Savings
2.4%		Return on Investment from Tax Savings

Total / Summary

1:	15,451	Cash Flow
2:	27,500	Appreciation Year 1
3:	6,072	Equity Build Up Year 1
4:	3,959	Tax Savings Year 1
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	52,982	Total Return from this Investment
	165,000	Downpayment + Closing Costs
	32.1%	Total Return from this Investment

Illustration of Internal Rate of Return over a 10-Year Holding Period
7915-7917 HARFORD ROAD

Purchase Price	550,000	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Annual Rent	4.0%	67,639	70,345	73,159	76,085	79,128	82,293	85,585	89,009	92,569	96,272
Vacancy	3.0%	2,029	2,110	2,195	2,283	2,374	2,469	2,568	2,670	2,777	2,888
Effective Income		65,610	68,234	70,964	73,802	76,754	79,825	83,018	86,338	89,792	93,383
Expenses	4.0%	16,409	17,065	17,748	18,458	19,196	19,964	20,763	21,593	22,457	23,355
Exp as a percent of Annual Rent		25%	25%	25%	25%	25%	25%	25%	25%	25%	25%
Exp per unit	4	4,102	4,266	4,437	4,614	4,799	4,991	5,191	5,398	5,614	5,839
NOI	0	49,201	51,169	53,216	55,344	57,558	59,861	62,255	64,745	67,335	70,028
Debt Service	\$ 2,982	35,779	35,779	35,779	35,779	35,779	35,779	35,779	35,779	35,779	35,779
Before Tax Cash Flow	(165,000)	13,422	15,390	17,437	19,566	21,779	24,082	26,476	28,966	31,556	406,691
17.7% Internal Rate of Return											
NOI		49,201	51,169	53,216	55,344	57,558	59,861	62,255	64,745	67,335	70,028
Less Interest		29,707	29,252	28,763	28,237	27,671	27,064	26,410	25,708	24,953	24,142
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		4,827	7,250	9,786	12,441	15,220	18,130	21,178	24,370	27,715	31,220
Pass Thru Entity	20%	(965)	(1,450)	(1,957)	(2,488)	(3,044)	(3,626)	(4,236)	(4,874)	(5,543)	(6,244)
Taxable Income	0	3,862	5,800	7,829	9,953	12,176	14,504	16,942	19,496	22,172	24,976
Tax @ *	37%	1,429	2,146	2,897	3,683	4,505	5,367	6,269	7,214	8,204	9,241
After Tax Cash Flow	(165,000)	11,993	13,244	14,540	15,883	17,274	18,715	20,207	21,753	23,352	338,304
14.6% Internal Rate of Return											
Purchase	550,000								Assume a Sale at End of Year 10		
L-V	75%								Annual Rent Roll		96,272
Loan	412,500								GRM		7.7
Down Payment	137,500					annual appreciation	3.1%		Price		743,680
Cap Improvement	-								Sale Costs		6%
Closing Costs	27,500								Less: Basis		44,621
Initial Investment	165,000								Gain		295,726
Rate	7.25%								Tax @		20%
Term	25								Mortgage Balance		326,618
P&I	\$2,981.58								Sale Proceeds Before Tax		372,441
									Sale Proceeds After Tax		313,296
Mortgage Amortization		1	2	3	4	5	6	7	8	9	10
412,500 Beg Bal		412,500	406,428	399,901	392,885	385,343	377,235	368,520	359,152	349,081	338,255
7.25% Prin		6,072	6,527	7,016	7,542	8,107	8,715	9,368	10,071	10,826	11,637
25.0 Int		29,707	29,252	28,763	28,237	27,671	27,064	26,410	25,708	24,953	24,142
2,982 Bal EOY		406,428	399,901	392,885	385,343	377,235	368,520	359,152	349,081	338,255	326,618
Cost Recovery / Depreciation		550,000	550,000	Building	80%	440,000	Land	20%	110,000	Life	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 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%.