

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.

48,000	+	Rental Income
12,526	-	Operating Expenses
26,645	-	Mortgage Payments
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8,829	=	Cash Flow
133,500	/	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.

445,000	=	Acquisition Price
5%	*	First Year Appreciation
467,250	=	Value at the end of Year 1.
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22,250	=	Amount of Value Increase
133,500	/	Downpayment + Closing Costs
17%	=	Return on Investment from Appreciation

3 **Equity Build-Up**

7.00% 30 \$ 2,220.45

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

333,750	=	Loan Amount at Closing
330,360	=	Loan Amount at the end of Year 1
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3,390	-	Equity Build-Up in Year 1
133,500	/	Downpayment + Closing Costs
2.5%	=	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.

35,474	=	Cash Flow Before Loan Payments (rents less expenses)
13,755	-	Depreciation (assumes 15% land, 27.5 year recovery)
23,255	-	Mortgage Interest
(1,536)	=	Taxable Income Year 1
33%	*	Marginal Tax Rate
(507)	=	Federal Income Tax
(507)		Federal Income Tax
8,829	/	Cash Flow
-5.7%	=	Effective Tax Rate on This Investment
2,913	=	Tax if Cash Flow came from a non-preferred investment vehicle
(507)	-	Tax from this preferred investment vehicle.
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3,420	=	Income Tax Savings
2.6%	=	Return on Investment from Tax Savings

Total / Summary

1:	8,829	Cash Flow
2:	22,250	Appreciation Year 1
3:	3,390	Equity Build Up Year 1
4:	3,420	Tax Savings Year 1
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	37,889	Total Return from this Investment
	133,500	Downpayment + Closing Costs
	28.4%	Total Return from this Investment

Illustration of Internal Rate of Return over a 10-Year Holding Period

637 SOUTH PACA STREET

Purchase Price	445,000	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Annual Rent	4.0%	48,000	49,920	51,917	53,993	56,153	58,399	60,735	63,165	65,691	68,319
Expenses	4.0%	12,526	13,027	13,548	14,090	14,653	15,240	15,849	16,483	17,143	17,828
Exp as a percent of Annual Rent		26%	26%	26%	26%	26%	26%	26%	26%	26%	26%
Exp per unit	3	4,175	4,342	4,516	4,697	4,884	5,080	5,283	5,494	5,714	5,943
NOI	0	35,474	36,893	38,369	39,904	41,500	43,160	44,886	46,682	48,549	50,491
Debt Service	\$ 2,220	26,645	26,645	26,645	26,645	26,645	26,645	26,645	26,645	26,645	26,645
Before Tax Cash Flow	(133,500)	8,829	10,248	11,723	13,258	14,854	16,514	18,241	20,036	21,903	332,818
16.5% Internal Rate of Return											
NOI		35,474	36,893	38,369	39,904	41,500	43,160	44,886	46,682	48,549	50,491
Less Interest		23,255	23,010	22,747	22,465	22,163	21,839	21,492	21,119	20,720	20,291
Less Depreciation		12,945	12,945	12,945	12,945	12,945	12,945	12,945	12,945	12,945	12,945
Taxable Income	0	(726)	938	2,676	4,493	6,391	8,375	10,449	12,617	14,884	17,254
Tax @	25%	(182)	234	669	1,123	1,598	2,094	2,612	3,154	3,721	4,313
After Tax Cash Flow	(133,500)	9,010	10,013	11,054	12,135	13,257	14,421	15,629	16,882	18,183	272,539
14.2% Internal Rate of Return											
Purchase	445,000								Assume a Sale at End of Year 10		
L-V	75%								Annual Rent Roll		68,319
Loan	333,750								GRM		9.3
Down Payment	111,250						annual appreciation	3.6%	Price		633,374
Cap Improvement	-								Sale Costs	6%	38,002
Closing Costs	22,250								Less: Basis		315,545
Initial Investment	133,500								Gain		279,826
Rate	7.00%								Tax @	20%	55,965
Term	30								Mortgage Balance		286,399
P&I	\$2,220.45								Sale Proceeds Before Tax		308,973
									Sale Proceeds After Tax		253,007
Mortgage Amortization		1	2	3	4	5	6	7	8	9	10
333,750	Beg Bal	333,750	330,360	326,724	322,826	318,646	314,164	309,358	304,204	298,678	292,753
7.00%	Prin	3,390	3,635	3,898	4,180	4,482	4,806	5,154	5,526	5,926	6,354
30.0	Int	23,255	23,010	22,747	22,465	22,163	21,839	21,492	21,119	20,720	20,291
2,220	Bal EOY	330,360	326,724	322,826	318,646	314,164	309,358	304,204	298,678	292,753	286,399
Cost Recovery / Depreciation		445,000	445,000	Building	80%	356,000	Land	20%	89,000	Life	27.5
		12,945	12,945	12,945	12,945	12,945	12,945	12,945	12,945	12,945	12,945
Basis		432,055	419,109	406,164	393,218	380,273	367,327	354,382	341,436	328,491	315,545