

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.

77,231	+	Rental Income
22,452	-	Operating Expenses
37,848	-	Mortgage Payments
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16,931	=	Cash Flow
178,500	/	Downpayment + Closing Costs
9.5%	=	Return on Investment from Cash Flow

**2 Appreciation**

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

595,000	=	Acquisition Price
5%	*	First Year Appreciation
624,750	=	Value at the end of Year 1.
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29,750	=	Amount of Value Increase
178,500	/	Downpayment + Closing Costs
17%	=	Return on Investment from Appreciation

**3 Equity Build-Up**

7.00%      25 \$      3,154.00

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

446,250	=	Loan Amount at Closing
439,423	=	Loan Amount at the end of Year 1
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6,827	-	Equity Build-Up in Year 1
178,500	/	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.

54,779	=	Cash Flow Before Loan Payments (rents less expenses)
16,858	-	Depreciation (assumes 15% land, 30 year recovery)
31,021	-	Mortgage Interest
6,900	=	Taxable Income Year 1
5,520		Less 20% Exclusion for LLC Ownership under new tax law
37%	*	Marginal Tax Rate
2,042.31	=	Federal Income Tax
2,042		Federal Income Tax
16,931	/	Cash Flow
12.1%	=	Effective Tax Rate on This Investment
6,265	=	Tax if Cash Flow came from a non-preferred investment vehicle
2,042	-	Tax from this preferred investment vehicle.
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4,222	=	Income Tax Savings
2.4%		Return on Investment from Tax Savings

**Total / Summary**

1:	16,931	Cash Flow
2:	29,750	Appreciation Year 1
3:	6,827	Equity Build Up Year 1
4:	4,222	Tax Savings Year 1
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	57,730	Total Return from this Investment
	178,500	Downpayment + Closing Costs
	32.3%	Total Return from this Investment

**Illustration of Internal Rate of Return over a 10-Year Holding Period**  
**2654 MARYLAND AVENUE**

Purchase Price	595,000	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Annual Rent	4.0%	77,231	80,321	83,533	86,875	90,350	93,964	97,722	101,631	105,697	109,924
Vacancy	3.0%	2,317	2,410	2,506	2,606	2,710	2,819	2,932	3,049	3,171	3,298
Effective Income		74,914	77,911	81,027	84,269	87,639	91,145	94,791	98,582	102,526	106,627
Expenses	4.0%	22,452	23,350	24,284	25,256	26,266	27,316	28,409	29,545	30,727	31,956
Exp as a percent of Annual Rent		30%	30%	30%	30%	30%	30%	30%	30%	30%	30%
Exp per unit	3	7,484	7,783	8,095	8,419	8,755	9,105	9,470	9,848	10,242	10,652
NOI	0	52,462	54,561	56,743	59,013	61,373	63,828	66,382	69,037	71,798	74,670
Debt Service	\$ 3,154	37,848	37,848	37,848	37,848	37,848	37,848	37,848	37,848	37,848	37,848
<b>Before Tax Cash Flow</b>	<b>(178,500)</b>	<b>14,614</b>	<b>16,713</b>	<b>18,895</b>	<b>21,165</b>	<b>23,525</b>	<b>25,980</b>	<b>28,534</b>	<b>31,189</b>	<b>33,950</b>	<b>550,628</b>
<b>19.6% Internal Rate of Return</b>											
NOI		52,462	54,561	56,743	59,013	61,373	63,828	66,382	69,037	71,798	74,670
Less Interest		31,021	30,528	29,999	29,431	28,823	28,170	27,471	26,720	25,916	25,053
Less Depreciation		15,867	15,867	15,867	15,867	15,867	15,867	15,867	15,867	15,867	15,867
Taxable Income to Individuals		5,574	8,166	10,878	13,715	16,684	19,792	23,044	26,450	30,016	33,750
Pass Thru Entity	20%	(1,115)	(1,633)	(2,176)	(2,743)	(3,337)	(3,958)	(4,609)	(5,290)	(6,003)	(6,750)
Taxable Income	0	4,460	6,533	8,702	10,972	13,347	15,833	18,435	21,160	24,013	27,000
Tax @ *	37%	1,650	2,417	3,220	4,060	4,939	5,858	6,821	7,829	8,885	9,990
<b>After Tax Cash Flow</b>	<b>(178,500)</b>	<b>12,964</b>	<b>14,296</b>	<b>15,675</b>	<b>17,105</b>	<b>18,587</b>	<b>20,122</b>	<b>21,712</b>	<b>23,360</b>	<b>25,066</b>	<b>454,963</b>
<b>16.4% Internal Rate of Return</b>											
Purchase	595,000										
L-V	75%										109,924
Loan	446,250										8.4
Down Payment	148,750										919,901
Cap Improvement	-										55,194
Closing Costs	29,750										436,333
Initial Investment	178,500										428,374
Rate	7.00%										85,675
Term	25										350,902
P&I	\$3,154.00										513,806
											428,131
<b>Mortgage Amortization</b>		1	2	3	4	5	6	7	8	9	10
446,250 Beg Bal		446,250	439,423	432,103	424,253	415,836	406,811	397,133	386,756	375,628	363,696
7.00% Prin		6,827	7,320	7,849	8,417	9,025	9,678	10,377	11,128	11,932	12,795
25.0 Int		31,021	30,528	29,999	29,431	28,823	28,170	27,471	26,720	25,916	25,053
3,154 Bal EOY		439,423	432,103	424,253	415,836	406,811	397,133	386,756	375,628	363,696	350,902
<b>Cost Recovery / Depreciation</b>		595,000	595,000	Building	80%	476,000	Land	20%	119,000	Life	<b>30</b>
		15,867	15,867	15,867	15,867	15,867	15,867	15,867	15,867	15,867	15,867
Basis		579,133	563,267	547,400	531,533	515,667	499,800	483,933	468,067	452,200	436,333

\* 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%.