## 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
34,922 - Mortgage Payments
19,857 = Cash Flow
164,700 / Downpayment + Closing Costs
12.1\% = Return on Investment from Cash Flow

## 2 Appreciation

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

| 549,000 | $=$ Acquisiton Price |
| ---: | :--- |
| $5 \%$ | $*$ First Year Appreciation |
| 576,450 | $=$ Value at the end of Year 1. |
| 27,450 | $=$ Amount of Value Increase |
| 164,700 | $/$ Downpayment + Closing Costs |
| $17 \%$ | $=$ Return on Investment from Appreciation |

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

| 411,750 | $=$ Loan Amount at Closing |
| ---: | :--- |
| 405,451 | $=$ Loan Amount at the end of Year 1 |
| 6,299 | - Equity Build-Up in Year 1 |
| 164,700 | $/$ 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)
15,555 - Depreciation (assumes 15\% land, 30 year recovery)
28,623 - Mortgage Interest
10,601 = Taxable Income Year 1
8,481 Less 20\% Exclusion for LLC Ownership under new tax law
37\% * Marginal Tax Rate
3,137.98 = Federal Income Tax
3,138 Federal Income Tax
19,857 / Cash Flow
$15.8 \%=$ Effective Tax Rate on This Investment
$7,347=$ Tax if Cash Flow came from a non-preferred investment vehicle

| 3,138 | - |
| :---: | :--- |
| 4,209 | $=$ |
| $2.6 \%$ | Tax from this preferred investment vax Savings |
|  |  |
| Total / Summary on Investment from Tax Savi |  |
| 19,857 |  |
| 27,450 | Cash Flow |
| 6,299 | Equity Build Up Year 1 |
| 4,209 | Tax Savings Year 1 |
| 57,816 | Total Return from this Investment |
| 164,700 | Downpayment + Closing Costs |
| $35.1 \%$ | Total Return from this Investment |


| Illustration of Internal Rate of Return over a 10-Year Holding Period 2654 MARYLAND AVENUE |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Purchase Price | 549,000 | $\underline{2025}$ | $\underline{2026}$ | 2027 | $\underline{2028}$ | $\underline{2029}$ | 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 | \$ 2,910 | 34,922 | 34,922 | 34,922 | 34,922 | 34,922 | 34,922 | 34,922 | 34,922 | 34,922 | 34,922 |
| Before Tax Cash Flow | $(164,700)$ | 17,540 | 19,639 | 21,821 | 24,091 | 26,452 | 28,906 | 31,460 | 34,115 | 36,876 | 513,831 |
| $\mathbf{2 1 . 5 \%}$ Internal Rate of Return |  |  |  |  |  |  |  |  |  |  |  |
| NOI |  | 52,462 | 54,561 | 56,743 | 59,013 | 61,373 | 63,828 | 66,382 | 69,037 | 71,798 | 74,670 |
| Less Interest |  | 28,623 | 28,168 | 27,679 | 27,156 | 26,594 | 25,992 | 25,347 | 24,655 | 23,912 | 23,117 |
| Less Depreciation |  | 14,640 | 14,640 | 14,640 | 14,640 | 14,640 | 14,640 | 14,640 | 14,640 | 14,640 | 14,640 |
| Taxable Income to Individuals |  | 9,199 | 11,753 | 14,424 | 17,217 | 20,139 | 23,196 | 26,395 | 29,742 | 33,246 | 36,914 |
| Pass Thru Entity | 20\% | $(1,840)$ | $(2,351)$ | $(2,885)$ | $(3,443)$ | $(4,028)$ | $(4,639)$ | $(5,279)$ | $(5,948)$ | $(6,649)$ | $(7,383)$ |
| Taxable Income | 0 | 7,359 | 9,403 | 11,539 | 13,774 | 16,111 | 18,557 | 21,116 | 23,794 | 26,597 | 29,531 |
| Tax @ * | 37\% | 2,723 | 3,479 | 4,269 | 5,096 | 5,961 | 6,866 | 7,813 | 8,804 | 9,841 | 10,926 |
| After Tax Cash Flow | $(164,700)$ | 14,817 | 16,160 | 17,552 | 18,995 | 20,490 | 22,040 | 23,647 | 25,311 | 27,036 | 423,854 |
| 17.8\% Internal Rate of Return |  |  |  |  |  |  |  |  |  |  |  |
| Purchase | 549,000 |  |  |  |  |  |  | Assume a Sale at End of Year 10 |  |  |  |
| L-V | 75\% |  |  |  |  |  |  | Annual Rent Roll |  |  | 109,924 |
| Loan | 411,750 |  |  |  |  |  |  | GRM |  |  | 7.7 |
| Down Payment | 137,250 |  |  |  | annual appreciation 4.5\% |  |  | Price |  |  | 848,783 |
| Cap Improvement | - |  |  |  |  |  |  | Sale Costs |  | 6\% | 50,927 |
| Closing Costs | 27,450 |  |  |  |  |  |  | Less: Basis |  |  | 402,600 |
| Initial Investment | 164,700 |  |  |  |  |  |  | Gain |  |  | 395,256 |
| Rate | 7.00\% |  |  |  |  |  |  | Tax @ |  | 20\% | 79,051 |
| Term | 25 |  |  |  |  |  |  | Mortgage Balance |  |  | 323,773 |
| P\&I | \$2,910.16 |  |  |  |  |  |  | Sale Proceeds | fore Tax |  | 474,083 |
|  |  |  |  |  |  |  |  | Sale Proceeds After Tax |  |  | 395,032 |
| Mortgage Amortization |  | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| 411,750 | Beg Bal | 411,750 | 405,451 | 398,697 | 391,454 | 383,688 | 375,360 | 366,431 | 356,855 | 346,588 | 335,578 |
| 7.00\% | Prin | 6,299 | 6,754 | 7,243 | 7,766 | 8,328 | 8,930 | 9,575 | 10,267 | 11,010 | 11,805 |
| 25.0 | Int | 28,623 | 28,168 | 27,679 | 27,156 | 26,594 | 25,992 | 25,347 | 24,655 | 23,912 | 23,117 |
| 2,910 | Bal EOY | 405,451 | 398,697 | 391,454 | 383,688 | 375,360 | 366,431 | 356,855 | 346,588 | 335,578 | 323,773 |
| Cost Recovery / Depreciation |  | 549,000 | 549,000 | Building | 80\% | 439,200 | Land | 20\% | 109,800 | Life | 30 |
|  |  | 14,640 | 14,640 | 14,640 | 14,640 | 14,640 | 14,640 | 14,640 | 14,640 | 14,640 | 14,640 |
| Basis |  | 534,360 | 519,720 | 505,080 | 490,440 | 475,800 | 461,160 | 446,520 | 431,880 | 417,240 | 402,600 |
| ${ }^{*}$ 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 $\$ 500 \mathrm{k} / \$ 600 \mathrm{k}$ is $37 \%$. |  |  |  |  |  |  |  |  |  |  |  |

