

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.

52,572	+	Rental Income
16,299	-	Operating Expenses
27,021	-	Mortgage Payments
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9,252	=	Cash Flow
142,500	/	Downpayment + Closing Costs
6.5%	=	Return on Investment from Cash Flow

2 **Appreciation**

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

475,000	=	Acquisition Price
5%	*	First Year Appreciation
498,750	=	Value at the end of Year 1.
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23,750	=	Amount of Value Increase
142,500	/	Downpayment + Closing Costs
17%	=	Return on Investment from Appreciation

3 **Equity Build-Up**

6.50% 30 \$ 2,251.74

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

356,250	=	Loan Amount at Closing
352,268	=	Loan Amount at the end of Year 1
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3,982	-	Equity Build-Up in Year 1
142,500	/	Downpayment + Closing Costs
2.8%	=	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.

36,273	=	Cash Flow Before Loan Payments (rents less expenses)
13,458	-	Depreciation (assumes 15% land, 30 year recovery)
23,039	-	Mortgage Interest
(225)	=	Taxable Income Year 1
(180)		Less 20% Exclusion for LLC Ownership under new tax law
37%	*	Marginal Tax Rate
(66.54)	=	Federal Income Tax
(67)		Federal Income Tax
9,252	/	Cash Flow
-0.7%	=	Effective Tax Rate on This Investment
3,423	=	Tax if Cash Flow came from a non-preferred investment vehicle
(67)	-	Tax from this preferred investment vehicle.
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3,490	=	Income Tax Savings
2.4%	=	Return on Investment from Tax Savings

Total / Summary

1:	9,252	Cash Flow
2:	23,750	Appreciation Year 1
3:	3,982	Equity Build Up Year 1
4:	3,490	Tax Savings Year 1
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	40,473	Total Return from this Investment
	142,500	Downpayment + Closing Costs
	28.4%	Total Return from this Investment

**Illustration of Internal Rate of Return over a 10-Year Holding Period
3119 NORTH CALVERT STREET**

Purchase Price	475,000	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Annual Rent	4.0%	52,572	54,675	56,862	59,136	61,502	63,962	66,520	69,181	71,948	74,826
Vacancy	3.0%	1,577	1,640	1,706	1,774	1,845	1,919	1,996	2,075	2,158	2,245
Effective Income		50,995	53,035	55,156	57,362	59,657	62,043	64,525	67,106	69,790	72,582
Expenses	4.0%	16,299	16,951	17,630	18,335	19,068	19,831	20,624	21,449	22,307	23,199
Exp as a percent of Annual Rent		32%	32%	32%	32%	32%	32%	32%	32%	32%	32%
Exp per unit	2	8,150	8,476	8,815	9,167	9,534	9,915	10,312	10,724	11,153	11,600
NOI	0	34,695	36,083	37,527	39,028	40,589	42,212	43,901	45,657	47,483	49,382
Debt Service	\$ 2,252	27,021	27,021	27,021	27,021	27,021	27,021	27,021	27,021	27,021	27,021
Before Tax Cash Flow	(142,500)	7,674	9,062	10,506	12,007	13,568	15,191	16,880	18,636	20,462	355,855
15.4% Internal Rate of Return											
NOI		34,695	36,083	37,527	39,028	40,589	42,212	43,901	45,657	47,483	49,382
Less Interest		23,039	22,772	22,488	22,184	21,860	21,515	21,146	20,752	20,333	19,885
Less Depreciation		12,667	12,667	12,667	12,667	12,667	12,667	12,667	12,667	12,667	12,667
Taxable Income to Individuals		(1,010)	644	2,372	4,177	6,062	8,031	10,088	12,238	14,484	16,831
Pass Thru Entity	20%	202	(129)	(474)	(835)	(1,212)	(1,606)	(2,018)	(2,448)	(2,897)	(3,366)
Taxable Income	0	(808)	515	1,898	3,341	4,849	6,425	8,071	9,790	11,587	13,465
Tax @ *	37%	(299)	191	702	1,236	1,794	2,377	2,986	3,622	4,287	4,982
After Tax Cash Flow	(142,500)	7,974	8,872	9,803	10,770	11,774	12,814	13,894	15,013	16,175	293,438
13.1% Internal Rate of Return											
Purchase	475,000										
L-V	75%										74,826
Loan	356,250										9.0
Down Payment	118,750										676,073
Cap Improvement	-									6%	40,564
Closing Costs	23,750										348,333
Initial Investment	142,500										287,175
Rate	6.50%									20%	57,435
Term	30										302,015
P&I	\$2,251.74										333,494
											276,059
Mortgage Amortization		1	2	3	4	5	6	7	8	9	10
356,250 Beg Bal		356,250	352,268	348,020	343,486	338,650	333,489	327,983	322,108	315,839	309,151
6.50% Prin		3,982	4,249	4,533	4,837	5,161	5,506	5,875	6,268	6,688	7,136
30.0 Int		23,039	22,772	22,488	22,184	21,860	21,515	21,146	20,752	20,333	19,885
2,252 Bal EOY		352,268	348,020	343,486	338,650	333,489	327,983	322,108	315,839	309,151	302,015
Cost Recovery / Depreciation		475,000	475,000	Building	80%	380,000	Land	20%	95,000	Life	30
		12,667	12,667	12,667	12,667	12,667	12,667	12,667	12,667	12,667	12,667
Basis		462,333	449,667	437,000	424,333	411,667	399,000	386,333	373,667	361,000	348,333

* 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%.