# 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.

54,708 + Rental Income
19,314 - Operating Expenses
25,126 - Mortgage Payments

10,268 = Cash Flow
118,500 / Downpayment + Closing Costs
8.7% = Return on Investment from Cash Flow

## 2 Appreciation

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

395,000 = Acquisiton Price
5% \* First Year Appreciation
414,750 = Value at the end of Year 1.

19,750 = Amount of Value Increase
118,500 / 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.

296,250 = Loan Amount at Closing
291,718 = Loan Amount at the end of Year 1
4,532 - Equity Build-Up in Year 1
118,500 / 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.

35,394 = Cash Flow Before Loan Payments (rents less expenses) 11,192 - Depreciation (assumes 15% land, 30 year recovery) 20,594 - Mortgage Interest 3,608 = Taxable Income Year 1 Less 20% Exclusion for LLC Ownership under new tax law 2.887 \* Marginal Tax Rate 37% 1,068.04 = Federal Income Tax 1,068 Federal Income Tax 10.268 / Cash Flow 10.4% = Effective Tax Rate on This Investment 3,799 = Tax if Cash Flow came from a non-preferred investment vehicle - Tax from this preferred investment vehicle. 1,068 2,731 = Income Tax Savings 2.3% Return on Investment from Tax Savings

# Total / Summary

| 1:        | 10,268                   | Cash Flow                         |  |  |  |  |
|-----------|--------------------------|-----------------------------------|--|--|--|--|
| 2:        | 19,750                   | Appreciation Year 1               |  |  |  |  |
| 3:        | 4,532                    | Equity Build Up Year 1            |  |  |  |  |
| <i>4:</i> | 2,731 Tax Savings Year 1 |                                   |  |  |  |  |
|           | 37,281                   | Total Return from this Investment |  |  |  |  |
|           | 118,500                  | Downpayment + Closing Costs       |  |  |  |  |
|           | 31.5%                    | Total Return from this Investment |  |  |  |  |

|                                      |                                 |                        | Illustration of | Internal Rate   | of Return ove   | er a 10-Year H    | oldina Period  | 1                       |                |         |             |
|--------------------------------------|---------------------------------|------------------------|-----------------|-----------------|-----------------|-------------------|----------------|-------------------------|----------------|---------|-------------|
|                                      |                                 |                        |                 |                 | T 25TH S        |                   | <b>y</b>       |                         |                |         |             |
| Purchase Price                       | 395,000                         | <u>2025</u>            | <u>2026</u>     | <u>2027</u>     | <u>2028</u>     | <u>2029</u>       | 2030           | 2031                    | 2032           | 2033    | <u>2034</u> |
| Annual Rent                          | 7.0%                            | 56,400                 | 60,348          | 64,572          | 69,092          | 73,929            | 79,104         | 84,641                  | 90,566         | 96,906  | 103,689     |
| Vacancy                              | 3.0%                            | 1,692                  | 1,810           | 1,937           | 2,073           | 2,218             | 2,373          | 2,539                   | 2,717          | 2,907   | 3,111       |
| Effective Income                     |                                 | 54,708                 | 58,538          | 62,635          | 67,020          | 71,711            | 76,731         | 82,102                  | 87,849         | 93,999  | 100,578     |
| Expenses                             | 7.0%                            | 19,314                 | 20,666          | 22,113          | 23,661          | 25,317            | 27,089         | 28,985                  | 31,014         | 33,185  | 35,508      |
| Exp as a percent of Annual Rent 35%  |                                 | 35%                    | 35%             | 35%             | 35%             | 35%               | 35%            | 35%                     | 35%            | 35%     |             |
| Exp per unit                         | 4                               | 4,829                  | 5,167           | 5,528           | 5,915           | 6,329             | 6,772          | 7,246                   | 7,754          | 8,296   | 8,877       |
| NOI                                  | 0                               | 35,394                 | 37,871          | 40,522          | 43,359          | 46,394            | 49,642         | 53,117                  | 56,835         | 60,813  | 65,070      |
| Debt Service                         | \$ 2,094                        | 25,126                 | 25,126          | 25,126          | 25,126          | 25,126            | 25,126         | 25,126                  | 25,126         | 25,126  | 25,126      |
| Before Tax Cash Flow 24.6%           | (118,500)<br>Internal Rate of R | <b>10,268</b><br>eturn | 12,745          | 15,396          | 18,233          | 21,268            | 24,516         | 27,991                  | 31,709         | 35,687  | 510,725     |
| NOI                                  |                                 | 35,394                 | 37,871          | 40,522          | 43,359          | 46,394            | 49,642         | 53,117                  | 56,835         | 60,813  | 65,070      |
| Less Interest                        |                                 | 20,594                 | 20,266          | 19,915          | 19,538          | 19,134            | 18,701         | 18,237                  | 17,739         | 17,205  | 16,632      |
| Less Depreciation                    |                                 | 10,533                 | 10,533          | 10,533          | 10,533          | 10,533            | 10,533         | 10,533                  | 10,533         | 10,533  | 10,533      |
| Taxable Income to Indiv              | riduals                         | 4,267                  | 7,072           | 10,074          | 13,287          | 16,726            | 20,407         | 24,347                  | 28,563         | 33,075  | 37,905      |
| Pass Thru Entity                     | 20%                             | (853)                  | (1,414)         | (2,015)         | (2,657)         | (3,345)           | (4,081)        | (4,869)                 | (5,713)        |         | (7,581)     |
| Taxable Income                       | 0                               | 3,413                  | 5,657           | 8,059           | 10,630          | 13,381            | 16,326         | 19,477                  | 22,850         | 26,460  | 30,324      |
| Tax @ *                              | 37%                             | 1,263                  | 2,093           | 2,982           | 3,933           | 4,951             | 6,041          | 7,207                   | 8,455          | 9,790   | 11,220      |
| After Tax Cash Flow                  | (118,500)                       | 9,005                  | 10,652          | 12,414          | 14,300          | 16,317            | 18,475         | 20,784                  | 23,254         | 25,897  | 416,692     |
| 20.9%                                | Internal Rate of R              | eturn                  |                 |                 |                 |                   |                |                         |                |         |             |
| Purchase 395,000                     |                                 |                        |                 |                 |                 |                   |                | Assume a Sa             | le at End of \ | /ear 10 |             |
| L-V                                  | 75%                             |                        |                 |                 |                 |                   |                | Annual Rent F           |                |         | 103,689     |
| Loan                                 | 296,250                         |                        |                 |                 |                 |                   |                | GRM                     |                |         | 7.2         |
| Down Payment                         | 98,750                          |                        |                 |                 | annua           | l appreciation    | 6.6%           | Price                   |                |         | 748,651     |
| Cap Improvement                      | -                               |                        |                 |                 |                 | .,,               |                | Sale Costs              |                | 6%      | 44,919      |
| Closing Costs                        | 19,750                          |                        |                 |                 |                 |                   |                | Less: Basis             |                |         | 289,667     |
| Initial Investment                   | 118,500                         |                        |                 |                 |                 |                   |                | Gain                    |                |         | 414,065     |
| Rate                                 | 7.00%                           |                        |                 |                 |                 |                   |                | Tax @                   |                | 20%     | 82,813      |
| Term                                 | 25                              |                        |                 |                 |                 |                   |                | Mortgage Bala           | ance           |         | 232,951     |
| P&I                                  | \$2,093.83                      |                        |                 |                 |                 |                   |                | Sale Proceeds           | s Before Tax   |         | 470,780     |
|                                      |                                 |                        |                 |                 |                 |                   |                | Sale Proceeds After Tax |                |         | 387,967     |
| Mortgage Amortization 1              |                                 | 2                      | 3               | 4               | 5               | 6                 | 7              | 8                       | 9              | 10      |             |
| 296,250                              | Beg Bal                         | 296,250                | 291,718         | 286,858         | 281,647         | 276,060           | 270,068        | 263,643                 | 256,754        | 249,367 | 241,445     |
| 7.00%                                | Prin                            | 4,532                  | 4,860           | 5,211           | 5,588           | 5,992             | 6,425          | 6,889                   | 7,387          | 7,921   | 8,494       |
| 25.0                                 | Int                             | 20,594                 | 20,266          | 19,915          | 19,538          | 19,134            | 18,701         | 18,237                  | 17,739         | 17,205  | 16,632      |
| 2,094                                | Bal EOY                         | 291,718                | 286,858         | 281,647         | 276,060         | 270,068           | 263,643        | 256,754                 | 249,367        | 241,445 | 232,951     |
| Cost Recovery / Depreciation 395,000 |                                 | 395,000                | Building        | 80%             | 316,000         | Land              | 20%            | 79,000                  | Life           | 30      |             |
|                                      |                                 | 10,533                 | 10,533          | 10,533          | 10,533          | 10,533            | 10,533         | 10,533                  | 10,533         | 10,533  | 10,533      |
| Basis                                |                                 | 384,467                | 373,933         | 363,400         | 352,867         | 342,333           | 331,800        | 321,267                 | 310,733        | 300,200 | 289,667     |
| * Tax rate of 35% applie             | s to income of \$20             | 0,001 to \$500         | ,000 for single | s; \$400,001 to | \$600,000 for r | narried filing jo | intly. Margina | al rate above \$5       | 500k/\$600k is | 37%.    |             |

