## 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
2,887 Less 20\% Exclusion for LLC Ownership under new tax law
37\% * Marginal Tax Rate 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
1,068 - Tax from this preferred investment vehicle.
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 |
| 4: | 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 |


| IIlustration of Internal Rate of Return over a 10-Year Holding Period 28 EAST 25 TH STREET |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Purchase Price | 395,000 | $\underline{2025}$ | $\underline{2026}$ | $\underline{2027}$ | $\underline{2028}$ | $\underline{2029}$ | $\underline{2030}$ | $\underline{2031}$ | $\underline{2032}$ | $\underline{2033}$ | $\underline{2034}$ |
| 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 | $(118,500)$ | 10,268 | 12,745 | 15,396 | 18,233 | 21,268 | 24,516 | 27,991 | 31,709 | 35,687 | 510,725 |
| 24.6\% Internal Rate of Return |  |  |  |  |  |  |  |  |  |  |  |
| 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 Individuals |  | 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) | $(1,414)$ | $(2,015)$ | $(2,657)$ | $(3,345)$ | $(4,081)$ | $(4,869)$ | $(5,713)$ | $(6,615)$ | $(7,581)$ |
| 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 Return |  |  |  |  |  |  |  |  |  |  |  |
| Purchase | 395,000 |  |  |  |  |  |  | Assume a Sale at End of Year 10 |  |  |  |
| L-V | 75\% |  |  |  |  |  |  | Annual Rent Roll |  |  | 103,689 |
| Loan | 296,250 |  |  |  |  |  |  | GRM |  |  | 7.2 |
| Down Payment | 98,750 |  |  |  | annual 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 Balance |  |  | 232,951 |
| P\&I | \$2,093.83 |  |  |  |  |  |  | Sale Proceeds 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 |
|  | 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 $35 \%$ 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 $37 \%$. |  |  |  |  |  |  |  |  |  |  |  |

