## 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.

| 68,229 | + Rental Income |
| ---: | :--- |
| 27,394 | - Operating Expenses |
| 25,045 | - Mortgage Payments |
| 15,789 | $=$ Cash Flow |
| 115,500 | $/$ Downpayment + Closing Costs |
| $13.7 \%$ | $=$ Return on Investment from Cash Flow |

## 2 Appreciation

As the value of the property increases, your return on investment increases.
$385,000=$ Acquisiton Price
5\% * First Year Appreciation
$404,250=$ Value at the end of Year 1.
19,250 = Amount of Value Increase
115,500 / 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.

288,750 = Loan Amount at Closing
$284,500=$ Loan Amount at the end of Year 1
4,250 - Equity Build-Up in Year 1
115,500 / Downpayment + Closing Costs
$3.7 \%=$ 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.

40,834 = Cash Flow Before Loan Payments (rents less expenses)
10,908 - Depreciation (assumes 15\% land, 30 year recovery)
20,795 - Mortgage Interest
$9,131=$ Taxable Income Year 1
7,305 Less 20\% Exclusion for LLC Ownership under new tax law
37\% * Marginal Tax Rate
2,702.79 = Federal Income Tax
2,703 Federal Income Tax
15,789 / Cash Flow
$17.1 \%=$ Effective Tax Rate on This Investment
$5,842=$ Tax if Cash Flow came from a non-preferred investment vehicle
$2,703-$ Tax from this preferred investment vehicle.
$3,139=$ Income Tax Savings
2.7\% Return on Investment from Tax Savings

Total / Summary

| 1: | 15,789 | Cash Flow |
| ---: | ---: | :--- |
| 2: | 19,250 | Appreciation Year 1 |
| 3: | 4,250 | Equity Build Up Year 1 |
| 4: | 3,139 | Tax Savings Year 1 |
|  | 42,429 | Total Return from this Investment |
|  | 115,500 | Downpayment + Closing Costs |
|  | $36.7 \%$ | Total Return from this Investment |


| IIlustration of Internal Rate of Return over a 10-Year Holding Period 869 HOLLINS STREET |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Purchase Price | 385,000 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2031 | 2032 | 2033 | 2034 |
| Annual Rent | 3.0\% | 68,229 | 70,275 | 72,384 | 74,555 | 76,792 | 79,096 | 81,468 | 83,913 | 86,430 | 89,023 |
| Vacancy | 3.0\% | 2,047 | 2,108 | 2,172 | 2,237 | 2,304 | 2,373 | 2,444 | 2,517 | 2,593 | 2,671 |
| Effective Income |  | 66,182 | 68,167 | 70,212 | 72,319 | 74,488 | 76,723 | 79,024 | 81,395 | 83,837 | 86,352 |
| Expenses | 3.0\% | 27,394 | 28,216 | 29,063 | 29,934 | 30,832 | 31,757 | 32,710 | 33,691 | 34,702 | 35,743 |
| Exp as a percent of Annual Rent |  | 41\% | 41\% | 41\% | 41\% | 41\% | 41\% | 41\% | 41\% | 41\% | 41\% |
| Exp per unit | 5 | 5,479 | 5,643 | 5,813 | 5,987 | 6,166 | 6,351 | 6,542 | 6,738 | 6,940 | 7,149 |
| NOI | 0 | 38,787 | 39,951 | 41,150 | 42,384 | 43,656 | 44,965 | 46,314 | 47,704 | 49,135 | 50,609 |
| Debt Service | \$ 2,087 | 25,045 | 25,045 | 25,045 | 25,045 | 25,045 | 25,045 | 25,045 | 25,045 | 25,045 | 25,045 |
| 19.2\% Internal Rate of Return |  |  |  |  |  |  |  |  |  |  |  |
| NOI |  | 38,787 | 39,951 | 41,150 | 42,384 | 43,656 | 44,965 | 46,314 | 47,704 | 49,135 | 50,609 |
| Less Interest |  | 20,795 | 20,476 | 20,134 | 19,766 | 19,370 | 18,945 | 18,487 | 17,996 | 17,467 | 16,899 |
| Less Depreciation |  | 10,267 | 10,267 | 10,267 | 10,267 | 10,267 | 10,267 | 10,267 | 10,267 | 10,267 | 10,267 |
| Taxable Income to Individuals |  | 7,726 | 9,208 | 10,749 | 12,352 | 14,019 | 15,754 | 17,560 | 19,441 | 21,401 | 23,443 |
| Pass Thru Entity | 20\% | $(1,545)$ | $(1,842)$ | $(2,150)$ | $(2,470)$ | $(2,804)$ | $(3,151)$ | $(3,512)$ | $(3,888)$ | $(4,280)$ | $(4,689)$ |
| Taxable Income | 0 | 6,181 | 7,366 | 8,599 | 9,881 | 11,215 | 12,603 | 14,048 | 15,553 | 17,121 | 18,754 |
| Tax @ * | 37\% | 2,287 | 2,726 | 3,182 | 3,656 | 4,150 | 4,663 | 5,198 | 5,755 | 6,335 | 6,939 |
| $15.4 \%$ Internal Rate of Return |  |  |  |  |  |  |  |  |  |  |  |
| Purchase | 385,000 |  |  |  |  |  |  | Assume a Sal | t End of Y | ear 10 |  |
| L-V | 75\% |  |  |  |  |  |  | Annual Rent R |  |  | 89,023 |
| Loan | 288,750 |  |  |  |  |  |  | GRM |  |  | 5.5 |
| Down Payment | 96,250 |  |  |  | annual | preciation | 2.4\% | Price |  |  | 487,268 |
| Cap Improvement | - |  |  |  |  |  |  | Sale Costs |  | 6\% | 29,236 |
| Closing Costs | 19,250 |  |  |  |  |  |  | Less: Basis |  |  | 282,333 |
| Initial Investment | 115,500 |  |  |  |  |  |  | Gain |  |  | 175,698 |
| Rate | 7.25\% |  |  |  |  |  |  | Tax @ |  | 20\% | 35,140 |
| Term | 25 |  |  |  |  |  |  | Mortgage Bala |  |  | 228,633 |
| P\&I | \$2,087.10 |  |  |  |  |  |  | Sale Proceeds | fore Tax |  | 229,399 |
|  |  |  |  |  |  |  |  | Sale Proceeds | ter Tax |  | 194,259 |
| Mortgage Amortization |  | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| 288,750 | Beg Bal | 288,750 | 284,500 | 279,931 | 275,020 | 269,740 | 264,065 | 257,964 | 251,406 | 244,357 | 236,779 |
| 7.25\% | Prin | 4,250 | 4,569 | 4,911 | 5,279 | 5,675 | 6,101 | 6,558 | 7,049 | 7,578 | 8,146 |
| 25.0 | Int | 20,795 | 20,476 | 20,134 | 19,766 | 19,370 | 18,945 | 18,487 | 17,996 | 17,467 | 16,899 |
| 2,087 | Bal EOY | 284,500 | 279,931 | 275,020 | 269,740 | 264,065 | 257,964 | 251,406 | 244,357 | 236,779 | 228,633 |
| Cost Recovery / Depreciation |  | 385,000 | 385,000 | Building | 80\% | 308,000 | Land | 20\% | 77,000 | Life | 30 |
|  |  | 10,267 | 10,267 | 10,267 | 10,267 | 10,267 | 10,267 | 10,267 | 10,267 | 10,267 | 10,267 |
| Basis |  | 374,733 | 364,467 | 354,200 | 343,933 | 333,667 | 323,400 | 313,133 | 302,867 | 292,600 | 282,333 |
| * 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 $\$ 500 \mathrm{k} / \$ 600 \mathrm{k}$ is $37 \%$. |  |  |  |  |  |  |  |  |  |  |  |

