

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.

21,600	+	Rental Income	
6,803	-	Operating Expenses	
9,955	-	Mortgage Payments	
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4,842	=	Cash Flow	
52,500	/	Downpayment + Closing Costs	
9.2%	=	Return on Investment from Cash Flow	

2 **Appreciation**

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

175,000	=	Acquisition Price	
5%	*	First Year Appreciation	
183,750	=	Value at the end of Year 1.	
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8,750	=	Amount of Value Increase	
52,500	/	Downpayment + Closing Costs	
17%	=	Return on Investment from Appreciation	

3 **Equity Build-Up**

6.50% 30 \$ 829.59

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

131,250	=	Loan Amount at Closing	
129,783	=	Loan Amount at the end of Year 1	
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1,467	-	Equity Build-Up in Year 1	
52,500	/	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.

14,797	=	Cash Flow Before Loan Payments (rents less expenses)	
5,409	-	Depreciation (assumes 15% land, 27.5 year recovery)	
8,488	-	Mortgage Interest	
900	=	Taxable Income Year 1	
33%	*	Marginal Tax Rate	
297	=	Federal Income Tax	
297		Federal Income Tax	
4,842	/	Cash Flow	
6.1%	=	Effective Tax Rate on This Investment	
1,598	=	Tax if Cash Flow came from a non-preferred investment vehicle	
297	-	Tax from this preferred investment vehicle.	
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1,301	=	Income Tax Savings	
2.5%		Return on Investment from Tax Savings	

Total / Summary

1:	4,842	Cash Flow	
2:	8,750	Appreciation Year 1	
3:	1,467	Equity Build Up Year 1	
4:	1,301	Tax Savings Year 1	
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	16,360	Total Return from this Investment	
	52,500	Downpayment + Closing Costs	
	31.2%	Total Return from this Investment	

Illustration of Internal Rate of Return over a 10-Year Holding Period

628 EAST 37TH STREET

Purchase Price	175,000	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Annual Rent	4.0%	21,600	22,464	23,363	24,297	25,269	26,280	27,331	28,424	29,561	30,744
Expenses	3.0%	6,803	7,007	7,217	7,433	7,656	7,886	8,123	8,366	8,617	8,876
Exp as a percent of Annual Rent		31%	31%	31%	31%	30%	30%	30%	29%	29%	29%
Exp per unit	1	6,803	7,007	7,217	7,433	7,656	7,886	8,123	8,366	8,617	8,876
NOI	0	14,797	15,457	16,146	16,864	17,612	18,394	19,208	20,058	20,944	21,868
Debt Service	\$ 830	9,955	9,955	9,955	9,955	9,955	9,955	9,955	9,955	9,955	9,955
Before Tax Cash Flow	(52,500)	4,842	5,502	6,191	6,909	7,657	8,438	9,253	10,103	10,989	134,779
19.0% Internal Rate of Return											
NOI		14,797	15,457	16,146	16,864	17,612	18,394	19,208	20,058	20,944	21,868
Less Interest		8,488	8,390	8,285	8,173	8,054	7,926	7,791	7,646	7,491	7,326
Less Depreciation		5,091	5,091	5,091	5,091	5,091	5,091	5,091	5,091	5,091	5,091
Taxable Income	0	1,218	1,977	2,770	3,600	4,468	5,376	6,327	7,321	8,362	9,451
Tax @	25%	305	494	692	900	1,117	1,344	1,582	1,830	2,090	2,363
After Tax Cash Flow	(52,500)	4,538	5,008	5,498	6,009	6,540	7,094	7,671	8,272	8,898	110,407
16.2% Internal Rate of Return											
Purchase	175,000								Assume a Sale at End of Year 10		
L-V	75%								Annual Rent Roll		30,744
Loan	131,250								GRM		8.1
Down Payment	43,750						annual appreciation	3.6%	Price		249,080
Cap Improvement	-								Sale Costs	6%	14,945
Closing Costs	8,750								Less: Basis		124,091
Initial Investment	52,500								Gain		110,044
Rate	6.50%								Tax @	20%	22,009
Term	30								Mortgage Balance		111,269
P&I	\$829.59								Sale Proceeds Before Tax		122,866
									Sale Proceeds After Tax		100,857
Mortgage Amortization		1	2	3	4	5	6	7	8	9	10
131,250	Beg Bal	131,250	129,783	128,218	126,548	124,766	122,864	120,836	118,671	116,362	113,898
6.50%	Prin	1,467	1,565	1,670	1,782	1,901	2,029	2,164	2,309	2,464	2,629
30.0	Int	8,488	8,390	8,285	8,173	8,054	7,926	7,791	7,646	7,491	7,326
830	Bal EOY	129,783	128,218	126,548	124,766	122,864	120,836	118,671	116,362	113,898	111,269
Cost Recovery / Depreciation		175,000	175,000	Building	80%	140,000	Land	20%	35,000	Life	27.5
		5,091	5,091	5,091	5,091	5,091	5,091	5,091	5,091	5,091	5,091
Basis		169,909	164,818	159,727	154,636	149,545	144,455	139,364	134,273	129,182	124,091