## 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.

133,800 + Rental Income
37,499 - Operating Expenses
75,090 - Mortgage Payments
$21,211=$ Cash Flow

396,000 / Downpayment + Closing Costs
$5.4 \%=$ Return on Investment from Cash Flow

## 2 Appreciation

As the value of the property increases, your return on investment increases.
$1,320,000=$ Acquisiton Price
5\% * First Year Appreciation
$1,386,000=$ Value at the end of Year 1.
$66,000=$ Amount of Value Increase
396,000 / 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.

990,000 = Loan Amount at Closing
978,935 = Loan Amount at the end of Year 1
11,065 - Equity Build-Up in Year 1
396,000 / 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.

96,301 = Cash Flow Before Loan Payments (rents less expenses)
28,050 - Depreciation (assumes 15\% land, 30 year recovery)
64,024 - Mortgage Interest
$4,227=$ Taxable Income Year 1
3,381 Less 20\% Exclusion for LLC Ownership under new tax law
37\% * Marginal Tax Rate
1,251.07 = Federal Income Tax
1,251 Federal Income Tax
21,211 / Cash Flow
5.9\% = Effective Tax Rate on This Investment
$7,848=$ Tax if Cash Flow came from a non-preferred investment vehicle
1,251 - Tax from this preferred investment vehicle.
6,597 = Income Tax Savings
1.7\% Return on Investment from Tax Savings

Total / Summary

| 1: | 21,211 | Cash Flow |
| ---: | ---: | :--- |
| 2: | 66,000 | Appreciation Year 1 |
| 3: | 11,065 | Equity Build Up Year 1 |
| 4: | 6,597 | Tax Savings Year 1 |
|  | 104,874 | Total Return from this Investment |
|  | 396,000 | Downpayment + Closing Costs |
|  | $26.5 \%$ | Total Return from this Investment |


| IIlustration of Internal Rate of Return over a 10-Year Holding Period PORTFOLIO OF 4 RENTAL HOMES |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Purchase Price | 1,320,000 | $\underline{2025}$ | $\underline{2026}$ | 2027 | $\underline{2028}$ | 2029 | $\underline{2030}$ | $\underline{2031}$ | $\underline{2032}$ | $\underline{2033}$ | $\underline{2034}$ |
| Annual Rent | 4.0\% | 133,800 | 139,152 | 144,718 | 150,507 | 156,527 | 162,788 | 169,300 | 176,072 | 183,115 | 190,439 |
| Vacancy | 3.0\% | 4,014 | 4,175 | 4,342 | 4,515 | 4,696 | 4,884 | 5,079 | 5,282 | 5,493 | 5,713 |
| Effective Income |  | 129,786 | 134,977 | 140,377 | 145,992 | 151,831 | 157,905 | 164,221 | 170,790 | 177,621 | 184,726 |
| Expenses | 4.0\% | 37,499 | 38,999 | 40,559 | 42,182 | 43,869 | 45,624 | 47,448 | 49,346 | 51,320 | 53,373 |
| Exp as a percent of Annual Rent |  | 29\% | 29\% | 29\% | 29\% | 29\% | 29\% | 29\% | 29\% | 29\% | 29\% |
| Exp per unit | 4 | 9,375 | 9,750 | 10,140 | 10,545 | 10,967 | 11,406 | 11,862 | 12,337 | 12,830 | 13,343 |
| NOI | 96,301 | 92,287 | 95,978 | 99,817 | 103,810 | 107,962 | 112,281 | 116,772 | 121,443 | 126,301 | 131,353 |
| Debt Service | \$ 6,257 | 75,090 | 75,090 | 75,090 | 75,090 | 75,090 | 75,090 | 75,090 | 75,090 | 75,090 | 75,090 |
| Before Tax Cash Flow | $(376,200)$ | 17,197 | 20,889 | 24,728 | 28,720 | 32,873 | 37,191 | 41,683 | 46,353 | 51,211 | 983,025 |
| 15.3\% Internal Rate of Return |  |  |  |  |  |  |  |  |  |  |  |
| NOI |  | 92,287 | 95,978 | 99,817 | 103,810 | 107,962 | 112,281 | 116,772 | 121,443 | 126,301 | 131,353 |
| Less Interest |  | 64,024 | 63,283 | 62,492 | 61,649 | 60,749 | 59,788 | 58,763 | 57,670 | 56,503 | 55,259 |
| Less Depreciation |  | 35,200 | 35,200 | 35,200 | 35,200 | 35,200 | 35,200 | 35,200 | 35,200 | 35,200 | 35,200 |
| Taxable Income to Individuals |  | $(6,937)$ | $(2,505)$ | 2,125 | 6,961 | 12,014 | 17,293 | 22,809 | 28,573 | 34,598 | 40,894 |
| Pass Thru Entity | 20\% | 1,387 | 501 | (425) | $(1,392)$ | $(2,403)$ | $(3,459)$ | $(4,562)$ | $(5,715)$ | $(6,920)$ | $(8,179)$ |
| Taxable Income | 0 | $(5,550)$ | $(2,004)$ | 1,700 | 5,569 | 9,611 | 13,834 | 18,247 | 22,859 | 27,678 | 32,715 |
| Tax @ * | 37\% | $(2,053)$ | (741) | 629 | 2,061 | 3,556 | 5,119 | 6,751 | 8,458 | 10,241 | 12,105 |
| After Tax Cash Flow | $(376,200)$ | 19,251 | 21,630 | 24,099 | 26,660 | 29,317 | 32,073 | 34,931 | 37,896 | 40,970 | 811,311 |
| 13.1\% Internal Rate of Return |  |  |  |  |  |  |  |  |  |  |  |
| Purchase | 1,320,000 |  |  |  |  |  |  | Assume a Sale at End of Year 10 |  |  |  |
| L-V | 75\% |  |  |  |  |  |  | Annual Rent Roll |  |  | 190,439 |
| Loan | 990,000 |  |  |  |  |  |  | GRM |  |  | 9.9 |
| Down Payment | 330,000 |  |  |  | annual appreciation |  | 3.6\% | Price |  |  | 1,878,772 |
| Cap Improvement | - |  |  |  |  |  |  | Sale Costs |  | 6\% | 112,726 |
| Closing Costs | 46,200 |  |  |  |  |  |  | Less: Basis |  |  | 968,000 |
| Initial Investment | 376,200 |  |  |  |  |  |  | Gain |  |  | 798,045 |
| Rate | 6.50\% |  |  |  |  |  |  | Tax @ |  | 20\% | 159,609 |
| Term | 30 |  |  |  |  |  |  | Mortgage Balance |  |  | 839,284 |
| P\&I | \$6,257.47 |  |  |  |  |  |  | Sale Proceeds Before Tax |  |  | 926,762 |
|  |  |  |  |  |  |  |  | Sale Proceeds After Tax |  |  | 767,153 |
| Mortgage Amortization |  | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| 990,000 | Beg Bal | 990,000 | 978,935 | 967,128 | 954,531 | 941,090 | 926,749 | 911,447 | 895,121 | 877,701 | 859,115 |
| 6.50\% | Prin | 11,065 | 11,807 | 12,597 | 13,441 | 14,341 | 15,302 | 16,326 | 17,420 | 18,586 | 19,831 |
| 30.0 | Int | 64,024 | 63,283 | 62,492 | 61,649 | 60,749 | 59,788 | 58,763 | 57,670 | 56,503 | 55,259 |
| 6,257 | Bal EOY | 978,935 | 967,128 | 954,531 | 941,090 | 926,749 | 911,447 | 895,121 | 877,701 | 859,115 | 839,284 |
| Cost Recovery / Depreciation |  | 1,320,000 | 1,320,000 | Building | 80\% | 1,056,000 | Land | 20\% | 264,000 | Life | 30 |
|  |  | 35,200 | 35,200 | 35,200 | 35,200 | 35,200 | 35,200 | 35,200 | 35,200 | 35,200 | 35,200 |
| Basis |  | 1,284,800 | 1,249,600 | 1,214,400 | 1,179,200 | 1,144,000 | 1,108,800 | 1,073,600 | 1,038,400 | 1,003,200 | 968,000 |
| * 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 $37 \%$. |  |  |  |  |  |  |  |  |  |  |  |

