## 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.

25,800 + Rental Income
8,880 - Operating Expenses

| 11,263 | - Mortgage Payments |
| ---: | :--- |
| 5,657 | $=$ Cash Flow |

59,400 / Downpayment + Closing Costs
$9.5 \%=$ Return on Investment from Cash Flow

## 2 Appreciation

As the value of the property increases, your return on investment increases.
198,000 = Acquisiton Price
5\% * First Year Appreciation
$207,900=$ Value at the end of Year 1.
$9,900=$ Amount of Value Increase
59,400 / 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.
$148,500=$ Loan Amount at Closing
146,840 = Loan Amount at the end of Year 1
1,660 - Equity Build-Up in Year 1
59,400 / 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.

16,920 = Cash Flow Before Loan Payments (rents less expenses)
4,208 - Depreciation (assumes 15\% land, 30 year recovery)
9,604 - Mortgage Interest
$3,109=$ Taxable Income Year 1
2,487 Less 20\% Exclusion for LLC Ownership under new tax law
37\% * Marginal Tax Rate
$920.28=$ Federal Income Tax
920 Federal Income Tax
5,657 / Cash Flow
$16.3 \%=$ Effective Tax Rate on This Investment
$2,093=$ Tax if Cash Flow came from a non-preferred investment vehicle
920 - Tax from this preferred investment vehicle.
$1,173=$ Income Tax Savings
2.0\% Return on Investment from Tax Savings

Total / Summary

| 1: | 5,657 | Cash Flow |
| ---: | ---: | :--- |
| 2: | 9,900 | Appreciation Year 1 |
| 3: | 1,660 | Equity Build Up Year 1 |
| 4: | 1,173 | Tax Savings Year 1 |
|  | 18,389 | Total Return from this Investment |
|  | 59,400 | Downpayment + Closing Costs |
|  | $31.0 \%$ | Total Return from this Investment |


| Illustration of Internal Rate of Return over a 10-Year Holding Period 2931 \& 2935 PULASKI HIGHWAY |  |  |  |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Purchase Price | 198,000 | $\underline{2025}$ | 2026 | 2027 | $\underline{2028}$ | $\underline{2029}$ | 2030 | 2031 | $\underline{2032}$ | 2033 | 2034 |
| Annual Rent | 4.0\% | 25,800 | 26,832 | 27,905 | 29,021 | 30,182 | 31,390 | 32,645 | 33,951 | 35,309 | 36,721 |
| Vacancy | 3.0\% | 774 | 805 | 837 | 871 | 905 | 942 | 979 | 1,019 | 1,059 | 1,102 |
| Effective Income |  | 25,026 | 26,027 | 27,068 | 28,151 | 29,277 | 30,448 | 31,666 | 32,933 | 34,250 | 35,620 |
| Expenses | 4.0\% | 8,880 | 9,235 | 9,604 | 9,989 | 10,388 | 10,804 | 11,236 | 11,685 | 12,153 | 12,639 |
| Exp as a percent of Annual Rent |  | 35\% | 35\% | 35\% | 35\% | 35\% | 35\% | 35\% | 35\% | 35\% | 35\% |
| Exp per unit | 4 | 2,220 | 2,309 | 2,401 | 2,497 | 2,597 | 2,701 | 2,809 | 2,921 | 3,038 | 3,160 |
| NOI | 16,920 | 16,146 | 16,792 | 17,464 | 18,162 | 18,889 | 19,644 | 20,430 | 21,247 | 22,097 | 22,981 |
| Debt Service | \$ 939 | 11,263 | 11,263 | 11,263 | 11,263 | 11,263 | 11,263 | 11,263 | 11,263 | 11,263 | 11,263 |
| Before Tax Cash Flow | $(56,430)$ | 4,883 | 5,529 | 6,200 | 6,899 | 7,625 | 8,381 | 9,167 | 9,984 | 10,834 | 150,732 |
| 18.6\% Internal Rate of Return |  |  |  |  |  |  |  |  |  |  |  |
| NOI |  | 16,146 | 16,792 | 17,464 | 18,162 | 18,889 | 19,644 | 20,430 | 21,247 | 22,097 | 22,981 |
| Less Interest |  | 9,604 | 9,492 | 9,374 | 9,247 | 9,112 | 8,968 | 8,815 | 8,650 | 8,476 | 8,289 |
| Less Depreciation |  | 5,280 | 5,280 | 5,280 | 5,280 | 5,280 | 5,280 | 5,280 | 5,280 | 5,280 | 5,280 |
| Taxable Income to Individuals |  | 1,263 | 2,020 | 2,810 | 3,635 | 4,496 | 5,396 | 6,336 | 7,317 | 8,342 | 9,412 |
| Pass Thru Entity | 20\% | (253) | (404) | (562) | (727) | (899) | $(1,079)$ | $(1,267)$ | $(1,463)$ | $(1,668)$ | $(1,882)$ |
| Taxable Income | 0 | 1,010 | 1,616 | 2,248 | 2,908 | 3,597 | 4,317 | 5,068 | 5,853 | 6,673 | 7,530 |
| Tax @ * | 37\% | 374 | 598 | 832 | 1,076 | 1,331 | 1,597 | 1,875 | 2,166 | 2,469 | 2,786 |
| After Tax Cash Flow | $(56,430)$ | 4,509 | 4,931 | 5,369 | 5,823 | 6,294 | 6,784 | 7,291 | 7,818 | 8,365 | 124,004 |
| 15.7\% Internal Rate of Return |  |  |  |  |  |  |  |  |  |  |  |
| Purchase | 198,000 |  |  |  |  |  |  | Assume a Sale at End of Year 10 |  |  |  |
| L-V | 75\% |  |  |  |  |  |  | Annual Rent Roll |  |  | 36,721 |
| Loan | 148,500 |  |  |  |  |  |  | GRM |  |  | 7.7 |
| Down Payment | 49,500 |  |  |  | annual appreciation 3.6\% |  |  | Price |  |  | 281,816 |
| Cap Improvement | - |  |  |  |  |  |  | Sale Costs |  | 6\% | 16,909 |
| Closing Costs | 6,930 |  |  |  |  |  |  | Less: Basis |  |  | 145,200 |
| Initial Investment | 56,430 |  |  |  |  |  |  | Gain |  |  | 119,707 |
| Rate | 6.50\% |  |  |  |  |  |  | Tax @ |  | 20\% | 23,941 |
| Term | 30 |  |  |  |  |  |  | Mortgage Bala |  |  | 125,893 |
| P\&I | \$938.62 |  |  |  |  |  |  | Sale Proceeds Before Tax |  |  | 139,014 |
|  |  |  |  |  |  |  |  | Sale Proceeds After Tax |  |  | 115,073 |
| Mortgage Amortization |  | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| 148,500 | Beg Bal | 148,500 | 146,840 | 145,069 | 143,180 | 141,163 | 139,012 | 136,717 | 134,268 | 131,655 | 128,867 |
| 6.50\% | Prin | 1,660 | 1,771 | 1,890 | 2,016 | 2,151 | 2,295 | 2,449 | 2,613 | 2,788 | 2,975 |
| 30.0 | Int | 9,604 | 9,492 | 9,374 | 9,247 | 9,112 | 8,968 | 8,815 | 8,650 | 8,476 | 8,289 |
| 939 | Bal EOY | 146,840 | 145,069 | 143,180 | 141,163 | 139,012 | 136,717 | 134,268 | 131,655 | 128,867 | 125,893 |
| Cost Recovery / Depreciation |  | 198,000 | 198,000 | Building | 80\% | 158,400 | Land | 20\% | 39,600 | Life | 30 |
|  |  | 5,280 | 5,280 | 5,280 | 5,280 | 5,280 | 5,280 | 5,280 | 5,280 | 5,280 | 5,280 |
| Basis |  | 192,720 | 187,440 | 182,160 | 176,880 | 171,600 | 166,320 | 161,040 | 155,760 | 150,480 | 145,200 |
| * 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 $37 \%$. |  |  |  |  |  |  |  |  |  |  |  |

