

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.

149,568	+	Rental Income
34,592	-	Operating Expenses
93,500	-	Mortgage Payments
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21,476	=	Cash Flow
447,000	/	Downpayment + Closing Costs
4.8%	=	Return on Investment from Cash Flow

2 **Appreciation**

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

1,490,000	=	Acquisition Price
5%	*	First Year Appreciation
1,564,500	=	Value at the end of Year 1.
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74,500	=	Amount of Value Increase
447,000	/	Downpayment + Closing Costs
17%	=	Return on Investment from Appreciation

3 **Equity Build-Up**

6.85% 25 \$ 7,791.65

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

1,117,500	=	Loan Amount at Closing
1,100,007	=	Loan Amount at the end of Year 1
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17,493	-	Equity Build-Up in Year 1
447,000	/	Downpayment + Closing Costs
3.9%	=	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.

114,976	=	Cash Flow Before Loan Payments (rents less expenses)
46,055	-	Depreciation (assumes 15% land, 27.5 year recovery)
76,006	-	Mortgage Interest
(7,085)	=	Taxable Income Year 1
33%	*	Marginal Tax Rate
(2,338)	=	Federal Income Tax
(2,338)		Federal Income Tax
21,476	/	Cash Flow
-10.9%	=	Effective Tax Rate on This Investment
7,087	=	Tax if Cash Flow came from a non-preferred investment vehicle
(2,338)	-	Tax from this preferred investment vehicle.
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9,425	=	Income Tax Savings
2.1%	=	Return on Investment from Tax Savings

Total / Summary

1:	21,476	Cash Flow
2:	74,500	Appreciation Year 1
3:	17,493	Equity Build Up Year 1
4:	9,425	Tax Savings Year 1
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	122,895	Total Return from this Investment
	447,000	Downpayment + Closing Costs
	27.5%	Total Return from this Investment

**Illustration of Internal Rate of Return over a 10-Year Holding Period
727 - 729 SOUTH BOND STREET**

Purchase Price	1,490,000	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Annual Rent	4.0%	154,194	160,362	166,776	173,447	180,385	187,601	195,105	202,909	211,025	219,466
Vacancy	3.0%	4,626	4,811	5,003	5,203	5,412	5,628	5,853	6,087	6,331	6,584
Effective Income		149,568	155,551	161,773	168,244	174,974	181,973	189,251	196,822	204,694	212,882
Expenses	4.0%	34,592	35,976	37,415	38,912	40,468	42,087	43,770	45,521	47,342	49,236
Exp as a percent of Annual Rent		23%	23%	23%	23%	23%	23%	23%	23%	23%	23%
Exp per unit	8	4,324	4,497	4,677	4,864	5,059	5,261	5,471	5,690	5,918	6,154
NOI	0	114,976	119,575	124,358	129,332	134,506	139,886	145,481	151,301	157,353	163,647
Debt Service	\$ 7,792	93,500	93,500	93,500	93,500	93,500	93,500	93,500	93,500	93,500	93,500
Before Tax Cash Flow	(447,000)	21,476	26,075	30,858	35,833	41,006	46,386	51,981	57,801	63,853	1,188,627
15.7% Internal Rate of Return											
NOI		114,976	119,575	124,358	129,332	134,506	139,886	145,481	151,301	157,353	163,647
Less Interest		76,006	74,770	73,446	72,028	70,510	68,885	67,145	65,282	63,287	61,151
Less Depreciation		43,345	43,345	43,345	43,345	43,345	43,345	43,345	43,345	43,345	43,345
Taxable Income	0	(4,376)	1,460	7,567	13,959	20,650	27,656	34,991	42,673	50,720	59,150
Tax @	25%	(1,094)	365	1,892	3,490	5,163	6,914	8,748	10,668	12,680	14,788
After Tax Cash Flow	(447,000)	22,570	25,710	28,966	32,343	35,843	39,472	43,234	47,132	51,173	986,450
13.5% Internal Rate of Return											
Purchase	1,490,000							Assume a Sale at End of Year 10			
L-V	75%							Annual Rent Roll			219,466
Loan	1,117,500							GRM			9.7
Down Payment	372,500						annual appreciation	3.6%	Price		2,120,735
Cap Improvement	-							Sale Costs		6%	127,244
Closing Costs	74,500							Less: Basis			1,056,545
Initial Investment	447,000							Gain			936,945
Rate	6.85%							Tax @		20%	187,389
Term	25							Mortgage Balance			875,011
P&I	\$7,791.65							Sale Proceeds Before Tax			1,118,480
								Sale Proceeds After Tax			931,091
Mortgage Amortization		1	2	3	4	5	6	7	8	9	10
1,117,500	Beg Bal	1,117,500	1,100,007	1,081,276	1,061,222	1,039,750	1,016,761	992,146	965,791	937,572	907,360
6.85%	Prin	17,493	18,730	20,054	21,472	22,990	24,615	26,355	28,218	30,213	32,349
25.0	Int	76,006	74,770	73,446	72,028	70,510	68,885	67,145	65,282	63,287	61,151
7,792	Bal EOY	1,100,007	1,081,276	1,061,222	1,039,750	1,016,761	992,146	965,791	937,572	907,360	875,011
Cost Recovery / Depreciation		1,490,000	1,490,000	Building	80%	1,192,000	Land	20%	298,000	Life	27.5
		43,345	43,345	43,345	43,345	43,345	43,345	43,345	43,345	43,345	43,345
Basis		1,446,655	1,403,309	1,359,964	1,316,618	1,273,273	1,229,927	1,186,582	1,143,236	1,099,891	1,056,545