

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.

45,600	+	Rental Income
10,655	-	Operating Expenses
23,058	-	Mortgage Payments
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11,888	=	Cash Flow
118,500	/	Downpayment + Closing Costs
10.0%	=	Return on Investment from Cash Flow

2 **Appreciation**

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

395,000	=	Acquisition Price
5%	*	First Year Appreciation
414,750	=	Value at the end of Year 1.
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19,750	=	Amount of Value Increase
118,500	/	Downpayment + Closing Costs
17%	=	Return on Investment from Appreciation

3 **Equity Build-Up**

6.75% 30 \$ 1,921.47

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

296,250	=	Loan Amount at Closing
293,093	=	Loan Amount at the end of Year 1
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3,157	-	Equity Build-Up in Year 1
118,500	/	Downpayment + Closing Costs
2.7%	=	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.

34,945	=	Cash Flow Before Loan Payments (rents less expenses)
12,209	-	Depreciation (assumes 15% land, 27.5 year recovery)
19,900	-	Mortgage Interest
2,836	=	Taxable Income Year 1
33%	*	Marginal Tax Rate
936	=	Federal Income Tax
936		Federal Income Tax
11,888	/	Cash Flow
7.9%	=	Effective Tax Rate on This Investment
3,923	=	Tax if Cash Flow came from a non-preferred investment vehicle
936	-	Tax from this preferred investment vehicle.
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2,987	=	Income Tax Savings
2.5%		Return on Investment from Tax Savings

Total / Summary

1:	11,888	Cash Flow
2:	19,750	Appreciation Year 1
3:	3,157	Equity Build Up Year 1
4:	2,987	Tax Savings Year 1
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	37,782	Total Return from this Investment
	118,500	Downpayment + Closing Costs
	31.9%	Total Return from this Investment

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

2 2 5 E A S T 3 3 R D S T R E E T

Purchase Price	395,000	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Annual Rent	4.0%	45,600	47,424	49,321	51,294	53,346	55,479	57,699	60,006	62,407	64,903
Expenses	3.0%	10,655	10,974	11,303	11,642	11,992	12,352	12,722	13,104	13,497	13,902
Exp as a percent of Annual Rent		23%	23%	23%	23%	22%	22%	22%	22%	22%	21%
Exp per unit	1	10,655	10,974	11,303	11,642	11,992	12,352	12,722	13,104	13,497	13,902
NOI	0	34,945	36,450	38,018	39,651	41,354	43,128	44,976	46,903	48,910	51,001
Debt Service	\$ 1,921	23,058	23,058	23,058	23,058	23,058	23,058	23,058	23,058	23,058	23,058
Before Tax Cash Flow	(118,500)	11,888	13,392	14,960	16,594	18,296	20,070	21,919	23,845	25,852	303,715
19.6% Internal Rate of Return											
NOI		34,945	36,450	38,018	39,651	41,354	43,128	44,976	46,903	48,910	51,001
Less Interest		19,900	19,681	19,445	19,194	18,925	18,637	18,329	18,000	17,648	17,271
Less Depreciation		11,491	11,491	11,491	11,491	11,491	11,491	11,491	11,491	11,491	11,491
Taxable Income	0	3,554	5,278	7,081	8,967	10,938	13,000	15,156	17,412	19,771	22,239
Tax @	25%	889	1,320	1,770	2,242	2,735	3,250	3,789	4,353	4,943	5,560
After Tax Cash Flow	(118,500)	10,999	12,073	13,190	14,352	15,562	16,820	18,130	19,492	20,909	248,478
16.7% Internal Rate of Return											
Purchase	395,000								Assume a Sale at End of Year 10		
L-V	75%								Annual Rent Roll		64,903
Loan	296,250								GRM		8.7
Down Payment	98,750							annual appreciation	3.6%	Price	562,208
Cap Improvement	-								Sale Costs	6%	33,732
Closing Costs	19,750								Less: Basis		280,091
Initial Investment	118,500								Gain		248,385
Rate	6.75%								Tax @	20%	49,677
Term	30								Mortgage Balance		252,704
P&I	\$1,921.47								Sale Proceeds Before Tax		275,771
									Sale Proceeds After Tax		226,095
Mortgage Amortization		1	2	3	4	5	6	7	8	9	10
296,250	Beg Bal	296,250	293,093	289,716	286,103	282,240	278,107	273,686	268,958	263,900	258,491
6.75%	Prin	3,157	3,377	3,612	3,864	4,133	4,421	4,728	5,058	5,410	5,786
30.0	Int	19,900	19,681	19,445	19,194	18,925	18,637	18,329	18,000	17,648	17,271
1,921	Bal EOY	293,093	289,716	286,103	282,240	278,107	273,686	268,958	263,900	258,491	252,704
Cost Recovery / Depreciation		395,000	395,000	Building	80%	316,000	Land	20%	79,000	Life	27.5
		11,491	11,491	11,491	11,491	11,491	11,491	11,491	11,491	11,491	11,491
Basis		383,509	372,018	360,527	349,036	337,545	326,055	314,564	303,073	291,582	280,091