

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.

46,080	+	Rental Income
16,870	-	Operating Expenses
20,658	-	Mortgage Payments
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8,553	=	Cash Flow
103,500	/	Downpayment + Closing Costs
8.3%	=	Return on Investment from Cash Flow

2 **Appreciation**

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

345,000	=	Acquisition Price
5%	*	First Year Appreciation
362,250	=	Value at the end of Year 1.
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17,250	=	Amount of Value Increase
103,500	/	Downpayment + Closing Costs
17%	=	Return on Investment from Appreciation

3 **Equity Build-Up**

7.00% 30 \$ 1,721.47

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

258,750	=	Loan Amount at Closing
256,122	=	Loan Amount at the end of Year 1
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2,628	-	Equity Build-Up in Year 1
103,500	/	Downpayment + Closing Costs
2.5%	=	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.

29,210	=	Cash Flow Before Loan Payments (rents less expenses)
9,775	-	Depreciation (assumes 15% land, 30 year recovery)
18,029	-	Mortgage Interest
1,406	=	Taxable Income Year 1
1,125		Less 20% Exclusion for LLC Ownership under new tax law
37%	*	Marginal Tax Rate
416.19	=	Federal Income Tax
416		Federal Income Tax
8,553	/	Cash Flow
4.9%	=	Effective Tax Rate on This Investment
3,164	=	Tax if Cash Flow came from a non-preferred investment vehicle
416	-	Tax from this preferred investment vehicle.
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2,748	=	Income Tax Savings
2.7%		Return on Investment from Tax Savings

Total / Summary

1:	8,553	Cash Flow
2:	17,250	Appreciation Year 1
3:	2,628	Equity Build Up Year 1
4:	2,748	Tax Savings Year 1
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	31,179	Total Return from this Investment
	103,500	Downpayment + Closing Costs
	30.1%	Total Return from this Investment

Illustration of Internal Rate of Return over a 10-Year Holding Period
3 5 2 6 K E S W I C K A V E

Purchase Price	345,000	<u>2022</u>	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2026</u>	<u>2027</u>	<u>2028</u>	<u>2029</u>	<u>2030</u>	<u>2031</u>
Annual Rent	4.0%	46,080	47,923	49,840	51,834	53,907	56,063	58,306	60,638	63,064	65,586
Vacancy	3.0%	1,382	1,438	1,495	1,555	1,617	1,682	1,749	1,819	1,892	1,968
Effective Income		44,698	46,486	48,345	50,279	52,290	54,381	56,557	58,819	61,172	63,619
Expenses	4.0%	16,870	17,545	18,246	18,976	19,735	20,525	21,346	22,199	23,087	24,011
Exp as a percent of Annual Rent		38%	38%	38%	38%	38%	38%	38%	38%	38%	38%
Exp per unit	3	5,623	5,848	6,082	6,325	6,578	6,842	7,115	7,400	7,696	8,004
NOI	0	27,828	28,941	30,099	31,303	32,555	33,857	35,211	36,620	38,084	39,608
Debt Service	\$ 1,721	20,658	20,658	20,658	20,658	20,658	20,658	20,658	20,658	20,658	20,658
Before Tax Cash Flow	(103,500)	7,170	8,283	9,441	10,645	11,897	13,199	14,554	15,962	17,427	258,491
16.7% Internal Rate of Return											

NOI		27,828	28,941	30,099	31,303	32,555	33,857	35,211	36,620	38,084	39,608
Less Interest		18,029	17,839	17,635	17,417	17,183	16,932	16,662	16,373	16,064	15,732
Less Depreciation		9,200	9,200	9,200	9,200	9,200	9,200	9,200	9,200	9,200	9,200
Taxable Income to Individuals		599	1,902	3,263	4,686	6,172	7,725	9,349	11,046	12,821	14,676
Pass Thru Entity	20%	(120)	(380)	(653)	(937)	(1,234)	(1,545)	(1,870)	(2,209)	(2,564)	(2,935)
Taxable Income	0	479	1,521	2,611	3,748	4,938	6,180	7,479	8,837	10,257	11,741
Tax @ *	37%	177	563	966	1,387	1,827	2,287	2,767	3,270	3,795	4,344
After Tax Cash Flow	(103,500)	6,993	7,720	8,475	9,258	10,070	10,913	11,786	12,692	13,632	212,430
14.1% Internal Rate of Return											

		Assume a Sale at End of Year 10									
Purchase	345,000										
L-V	75%										65,586
Loan	258,750										7.5
Down Payment	86,250				annual appreciation		3.6%				491,043
Cap Improvement	-									6%	29,463
Closing Costs	17,250										253,000
Initial Investment	103,500										208,580
Rate	7.00%										20%
Term	30										41,716
P&I	\$1,721.47										222,040
											239,540
											197,824
Mortgage Amortization		1	2	3	4	5	6	7	8	9	10
258,750 Beg Bal		258,750	256,122	253,303	250,281	247,040	243,565	239,839	235,844	231,560	226,966
7.00% Prin		2,628	2,818	3,022	3,241	3,475	3,726	3,995	4,284	4,594	4,926
30.0 Int		18,029	17,839	17,635	17,417	17,183	16,932	16,662	16,373	16,064	15,732
1,721 Bal EOY		256,122	253,303	250,281	247,040	243,565	239,839	235,844	231,560	226,966	222,040
Cost Recovery / Depreciation		345,000	345,000	Building	80%	276,000	Land	20%	69,000	Life	30
		9,200	9,200	9,200	9,200	9,200	9,200	9,200	9,200	9,200	9,200
Basis		335,800	326,600	317,400	308,200	299,000	289,800	280,600	271,400	262,200	253,000

* 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 \$500k/\$600k is 37%.