# 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.

57,672 + Rental Income
11,266 - Operating Expenses
32,435 - Mortgage Payments
13,971 = Cash Flow
165,000 / Downpayment + Closing Costs
8.5% = Return on Investment from Cash Flow

### 2 Appreciation

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

550,000 = Acquisiton Price
5% \* First Year Appreciation
577,500 = Value at the end of Year 1.

27,500 = Amount of Value Increase
165,000 / 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.

412,500 = Loan Amount at Closing 408,187 = Loan Amount at the end of Year 1 4,313 - Equity Build-Up in Year 1 165,000 / Downpayment + Closing Costs 2.6% = 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.

46,406 = Cash Flow Before Loan Payments (rents less expenses) 15,583 - Depreciation (assumes 15% land, 30 year recovery) 28,123 - Mortgage Interest 2,700 = Taxable Income Year 1 Less 20% Exclusion for LLC Ownership under new tax law 2.160 \* Marginal Tax Rate 37% 799.32 = Federal Income Tax 799 Federal Income Tax / Cash Flow 13.971 5.7% = Effective Tax Rate on This Investment 5,169 = Tax if Cash Flow came from a non-preferred investment vehicle - Tax from this preferred investment vehicle. 799 4,370 = Income Tax Savings

Return on Investment from Tax Savings

## Total / Summary

2.6%

1:	13,971	Cash Flow					
2:	27,500	Appreciation Year 1					
3:	4,313	Equity Build Up Year 1					
<i>4:</i>	4,370	,370 Tax Savings Year 1					
	50,154	Total Return from this Investment					
	165,000	Downpayment + Closing Costs					
	30.4%	Total Return from this Investment					

			Illustration of	Internal Rate	of Return ove	er a 10-Vear H	loldina Perio	1				
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Purchase Price	550,000	2024	2025	2026	2027	2028	2029	2030	<u>2031</u>	2032	2033	
Annual Rent	4.0%	57,672	59,979	62,378	64,873	67,468	70,167	72,973	75,892	78,928	82,085	
Vacancy	3.0%	1,730	1,799	1,871	1,946	2,024	2,105	2,189	2,277	2,368	2,463	
Effective Income		55,942	58,180	60,507	62,927	65,444	68,062	70,784	73,616	76,560	79,623	
Expenses	4.0%	11,266	11,716	12,185	12,672	13,179	13,706	14,255	14,825	15,418	16,035	
Exp as a percent of Annual Rent 20%		20%	20%	20%	20%	20%	20%	20%	20%	20%		
Exp per unit	3	3,755	3,905	4,062	4,224	4,393	4,569	4,752	4,942	5,139	5,345	
NOI	0	44,676	46,463	48,322	50,255	52,265	54,355	56,530	58,791	61,142	63,588	
Debt Service	\$ 2,703	32,435	32,435	32,435	32,435	32,435	32,435	32,435	32,435	32,435	32,435	
Before Tax Cash Flow 17.1%	(165,000) Internal Rate of R	<b>12,241</b> eturn	14,028	15,886	17,819	19,829	21,920	24,094	26,355	28,707	414,288	
NOI		44,676	46,463	48,322	50,255	52,265	54,355	56,530	58,791	61,142	63,588	
Less Interest		28,123	27,818	27,491	27,142	26,767	26,367	25,938	25,478	24,987	24,460	
Less Depreciation		14,667	14,667	14,667	14,667	14,667	14,667	14,667	14,667	14,667	14,667	
Taxable Income to Individuals 1,887		3,979	6,164	8,446	10,831	13,322	15,925	18,646	21,489	24,461		
Pass Thru Entity	20%	(377)	(796)	(1,233)	(1,689)	(2,166)	(2,664)	(3,185)	(3,729)		(4,892)	
Taxable Income	0	1,510	3,183	4,931	6,757	8,664	10,657	12,740	14,916	17,191	19,569	
Tax @ *	37%	559	1,178	1,824	2,500	3,206	3,943	4,714	5,519	6,361	7,241	
After Tax Cash Flow	(165,000)	11,682	12,850	14,062	15,319	16,624	17,977	19,380	20,836	22,346	340,544	
	Internal Rate of R	eturn										
Purchase 550,000							Assume a Sa	le at End of \	ear 10			
L-V	75%							Annual Rent Roll		<u> </u>	82,085	
Loan	412,500							GRM			9.5	
Down Payment	137,500				annua	l appreciation	3.6%	Price			782,821	
Cap Improvement	-							Sale Costs		6%	46,969	
Closing Costs	27,500							Less: Basis			403,333	
Initial Investment	165,000							Gain			332,519	
Rate	6.85%							Tax @		20%	66,504	
Term	30							Mortgage Bala	ance		352,717	
P&I	\$2,702.94							Sale Proceeds	s Before Tax		383,135	
								Sale Proceeds After Tax			316,631	
Mortgage Amortization 1			2	3	4	5	6	7	8	9	10	
412,500		412,500	408,187	403,569	398,625	393,332	387,664	381,595	375,098	368,141	360,692	
6.85%		4,313	4,618	4,944	5,294	5,668	6,069	6,498	6,957	7,449	7,975	
30.0	Int	28,123	27,818	27,491	27,142	26,767	26,367	25,938	25,478	24,987	24,460	
2,703	Bal EOY	408,187	403,569	398,625	393,332	387,664	381,595	375,098	368,141	360,692	352,717	
Cost Recovery / Depreciation 550,000		550,000	Building	80%	440,000	Land	20%	110,000	Life	30		
		14,667	14,667	14,667	14,667	14,667	14,667	14,667	14,667	14,667	14,667	
Basis		535,333	520,667	506,000	491,333	476,667	462,000	447,333	432,667	418,000	403,333	
* Tax rate of 35% applie	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%.											

