

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.

30,600	+	Rental Income
8,566	-	Operating Expenses
13,797	-	Mortgage Payments
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8,236	=	Cash Flow
81,000	/	Downpayment + Closing Costs
10.2%	=	Return on Investment from Cash Flow

2 **Appreciation**

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

270,000	=	Acquisition Price
5%	*	First Year Appreciation
283,500	=	Value at the end of Year 1.
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13,500	=	Amount of Value Increase
81,000	/	Downpayment + Closing Costs
17%	=	Return on Investment from Appreciation

3 **Equity Build-Up**

5.50% 30 \$ 1,149.77

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

202,500	=	Loan Amount at Closing
199,772	=	Loan Amount at the end of Year 1
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2,728	-	Equity Build-Up in Year 1
81,000	/	Downpayment + Closing Costs
3.4%	=	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.

22,034	=	Cash Flow Before Loan Payments (rents less expenses)
8,345	-	Depreciation (assumes 15% land, 27.5 year recovery)
11,069	-	Mortgage Interest
2,619	=	Taxable Income Year 1
33%	*	Marginal Tax Rate
864	=	Federal Income Tax
864		Federal Income Tax
8,236	/	Cash Flow
10.5%	=	Effective Tax Rate on This Investment
2,718	=	Tax if Cash Flow came from a non-preferred investment vehicle
864	-	Tax from this preferred investment vehicle.
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1,854	=	Income Tax Savings
2.3%		Return on Investment from Tax Savings

Total / Summary

1:	8,236	Cash Flow
2:	13,500	Appreciation Year 1
3:	2,728	Equity Build Up Year 1
4:	1,854	Tax Savings Year 1
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	26,318	Total Return from this Investment
	81,000	Downpayment + Closing Costs
	32.5%	Total Return from this Investment

	A	B	C	D	E	F	G	H	I	J	K	L
1	Illustration of Internal Rate of Return over a 10-Year Holding Period											
2	2905 CHARLESTON AVENUE											
3	Purchase Price	270,000	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2026</u>	<u>2027</u>	<u>2028</u>
4	Annual Rent	3.5%	30,600	31,671	32,779	33,927	35,114	36,343	37,615	38,932	40,294	41,705
5	Expenses	3.5%	8,566	8,866	9,177	9,498	9,830	10,174	10,530	10,899	11,280	11,675
6	Exp as a percent of Annual Rent		28%	28%	28%	28%	28%	28%	28%	28%	28%	28%
7	Exp per unit	2	4,283	4,433	4,588	4,749	4,915	5,087	5,265	5,449	5,640	5,838
8	NOI	0	22,034	22,805	23,603	24,429	25,284	26,169	27,085	28,033	29,014	30,029
9	Debt Service	\$ 1,150	13,797	13,797	13,797	13,797	13,797	13,797	13,797	13,797	13,797	13,797
10	Before Tax Cash Flow	(81,000)	8,236	9,007	9,806	10,632	11,487	12,372	13,288	14,236	15,217	194,990
11	18.4% Internal Rate of Return											
13	NOI		22,034	22,805	23,603	24,429	25,284	26,169	27,085	28,033	29,014	30,029
14	Less Interest		11,069	10,916	10,753	10,581	10,400	10,208	10,006	9,792	9,566	9,327
15	Less Depreciation		7,855	7,855	7,855	7,855	7,855	7,855	7,855	7,855	7,855	7,855
16	Taxable Income to Individuals		3,110	4,035	4,995	5,993	7,030	8,106	9,225	10,386	11,593	12,848
17	Pass Thru Entity Deduct	20%	(622)	(807)	(999)	(1,199)	(1,406)	(1,621)	(1,845)	(2,077)	(2,319)	(2,570)
18	Taxable Income	0	2,488	3,228	3,996	4,795	5,624	6,485	7,380	8,309	9,275	10,278
19	Tax @ *	35%	871	1,130	1,399	1,678	1,968	2,270	2,583	2,908	3,246	3,597
20	After Tax Cash Flow	(81,000)	7,366	7,878	8,407	8,954	9,518	10,102	10,705	11,327	11,971	160,503
21	15.4% Internal Rate of Return											
22	Purchase	270,000										
23	L-V	75%										
24	Loan	202,500										
25	Down Payment	67,500										
26	Cap Improvement	-										
27	Closing Costs	13,500										
28	Initial Investment	81,000										
29	Rate	5.50%										
30	Term	30										
31	P&I	\$1,149.77										
32												
33	Mortgage Amortization		1	2	3	4	5	6	7	8	9	10
34	202,500 Beg Bal		202,500	199,772	196,890	193,846	190,630	187,233	183,644	179,852	175,847	171,615
35	5.50% Prin		2,728	2,882	3,044	3,216	3,397	3,589	3,792	4,005	4,231	4,470
36	30.0 Int		11,069	10,916	10,753	10,581	10,400	10,208	10,006	9,792	9,566	9,327
37	1,150 Bal EOY		199,772	196,890	193,846	190,630	187,233	183,644	179,852	175,847	171,615	167,146
43	Cost Recovery / Depreciation		270,000	270,000	Building	80%	216,000	Land	20%	54,000	Life	27.5
44			7,855	7,855	7,855	7,855	7,855	7,855	7,855	7,855	7,855	7,855
45	Basis		#####595/478	#####587/5<4	#####579/769	#####56;/8;5	#####563/:5:	#####555/;:6	#####548/34;	#####53:;497	#####4<<63<	#####4<4/788
46	* 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%.											