

## 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.

26,616	+	Rental Income
9,009	-	Operating Expenses
6,870	-	Mortgage Payments
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10,737	=	Cash Flow
51,000	/	Downpayment + Closing Costs
21.1%	=	Return on Investment from Cash Flow

### 2 **Appreciation**

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

170,000	=	Acquisition Price
5%	*	First Year Appreciation
178,500	=	Value at the end of Year 1.
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8,500	=	Amount of Value Increase
51,000	/	Downpayment + Closing Costs
17%	=	Return on Investment from Appreciation

### 3 **Equity Build-Up**

3.50%      30 \$      572.53

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

127,500	=	Loan Amount at Closing
125,053	=	Loan Amount at the end of Year 1
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2,447	-	Equity Build-Up in Year 1
51,000	/	Downpayment + Closing Costs
4.8%	=	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.

17,607	=	Cash Flow Before Loan Payments (rents less expenses)
5,255	-	Depreciation (assumes 15% land, 27.5 year recovery)
4,423	-	Mortgage Interest
7,929	=	Taxable Income Year 1
33%	*	Marginal Tax Rate
2,617	=	Federal Income Tax
2,617		Federal Income Tax
10,737	/	Cash Flow
24.4%	=	Effective Tax Rate on This Investment
3,543	=	Tax if Cash Flow came from a non-preferred investment vehicle
2,617	-	Tax from this preferred investment vehicle.
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927	=	Income Tax Savings
1.8%		Return on Investment from Tax Savings

### **Total / Summary**

1:	10,737	Cash Flow
2:	8,500	Appreciation Year 1
3:	2,447	Equity Build Up Year 1
4:	927	Tax Savings Year 1
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	22,610	Total Return from this Investment
	51,000	Downpayment + Closing Costs
	44.3%	Total Return from this Investment

**Illustration of Internal Rate of Return over a 10-Year Holding Period  
3401 MONDAWMIN AVE.**

Purchase Price	170,000	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Annual Rent	4.0%	26,616	27,681	28,788	29,939	31,137	32,382	33,678	35,025	36,426	37,883
Expenses	4.0%	9,009	9,369	9,744	10,133	10,539	10,960	11,399	11,855	12,329	12,822
Exp as a percent of Annual Rent		34%	34%	34%	34%	34%	34%	34%	34%	34%	34%
Exp per unit	1	9,009	9,369	9,744	10,133	10,539	10,960	11,399	11,855	12,329	12,822
NOI	0	17,607	18,312	19,044	19,806	20,598	21,422	22,279	23,170	24,097	25,061
Debt Service	\$ 573	6,870	6,870	6,870	6,870	6,870	6,870	6,870	6,870	6,870	6,870
<b>Before Tax Cash Flow</b>	<b>(51,000)</b>	<b>10,737</b>	<b>11,441</b>	<b>12,174</b>	<b>12,936</b>	<b>13,728</b>	<b>14,552</b>	<b>15,409</b>	<b>16,300</b>	<b>17,227</b>	<b>146,916</b>
<b>28.8% Internal Rate of Return</b>											
NOI		17,607	18,312	19,044	19,806	20,598	21,422	22,279	23,170	24,097	25,061
Less Interest		4,423	4,336	4,246	4,153	4,056	3,956	3,853	3,745	3,634	3,519
Less Depreciation		4,945	4,945	4,945	4,945	4,945	4,945	4,945	4,945	4,945	4,945
Taxable Income	0	8,239	9,030	9,852	10,708	11,596	12,520	13,481	14,479	15,517	16,596
Tax @	25%	2,060	2,257	2,463	2,677	2,899	3,130	3,370	3,620	3,879	4,149
<b>After Tax Cash Flow</b>	<b>(51,000)</b>	<b>8,677</b>	<b>9,184</b>	<b>9,711</b>	<b>10,259</b>	<b>10,829</b>	<b>11,422</b>	<b>12,038</b>	<b>12,680</b>	<b>13,347</b>	<b>121,387</b>
<b>23.7% Internal Rate of Return</b>											
Purchase	170,000								<b>Assume a Sale at End of Year 10</b>		
L-V	75%								Annual Rent Roll		37,883
Loan	127,500								GRM		6.4
Down Payment	42,500							annual appreciation	3.6%	Price	241,963
Cap Improvement	-								Sale Costs	6%	14,518
Closing Costs	8,500								Less: Basis		120,545
Initial Investment	51,000								Gain		106,900
Rate	3.50%								Tax @	20%	21,380
Term	30								Mortgage Balance		98,719
P&I	\$572.53								Sale Proceeds Before Tax		128,726
									Sale Proceeds After Tax		107,346
<b>Mortgage Amortization</b>		1	2	3	4	5	6	7	8	9	10
127,500	Beg Bal	127,500	125,053	122,519	119,895	117,178	114,364	111,450	108,432	105,307	102,071
3.50%	Prin	2,447	2,534	2,624	2,717	2,814	2,914	3,018	3,125	3,236	3,351
30.0	Int	4,423	4,336	4,246	4,153	4,056	3,956	3,853	3,745	3,634	3,519
573	Bal EOY	125,053	122,519	119,895	117,178	114,364	111,450	108,432	105,307	102,071	98,719
<b>Cost Recovery / Depreciation</b>		170,000	170,000	Building	80%	136,000	Land	20%	34,000	Life	27.5
		4,945	4,945	4,945	4,945	4,945	4,945	4,945	4,945	4,945	4,945
Basis		165,055	160,109	155,164	150,218	145,273	140,327	135,382	130,436	125,491	120,545