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Understanding and Maximizing the Value of Your Veterinary Property

Approaches that veterinary
property owners can take to
increase their property value
and their wealth



Speaker Bio



DANIEL EISENSTADT CEO, FOUNDER

- Co-Founder & President Community Veterinary Partners – Sold to OMERS in 2018
- 25 years of private equity, real estate & legal experience
- MBA, Harvard Business School; JD, University of Virginia School of Law; B.A. Clark University

Speaker Bio



PETER KILKELLY **CHIEF DEVELOPMENT OFFICER**

- Acquired More than 50 Veterinary Hospital Practices for VCA with Combined Revenue of Over \$130 Million
- Twenty years of veterinary experience in accounting and acquisitions
- Member of Vet Partners and Nat'l Assn of Certified Valuation Analysts
- B.A. Southern New Hampshire University

Terravet At A Glance

- **Terravet Owns/Manages Approximately 200+ Properties:**

- ~ Approximately \$500MM in real estate projected to be owned at end of Q2 2024*
- ~ 1.5MM square feet of real estate
- Leased to >30 different veterinary operators
- Terravet operates through closed-end funds and Terravet REIT which each have debt facilities comprised of a syndicate of banks led by Key Bank

- **Geographically Diversified Portfolio:**

- Geographic diversification: Properties located in >35 different states in the continental U.S.
- Terravet REIT and Terravet Fund III are projected to own >\$800MM in primarily veterinary real estate by 2028
- Terravet REIT (launched July 2022)
 - Terravet REIT owns approx. 650,000 square feet of real estate



Determining Property Value: Why Does It Matter?



Practice Investment: You can use the increased value of your property to pay for expansion and renovations that will improve your practice value:

- Build your dream practice that helps you recruit and retain the most talented veterinarians and staff
- Improve the quality of care for your patients
- Increase revenue for the practice
 - fund a staff retention program
 - invest in new technologies



Personal Investment: You can use the increased value of your property to pay for personal investments

- Your dream lake home
- Sailing adventures
- College fund
- Retirement investments

- ▶ Knowing the value of your assets matters...
- ▶ There are approaches that veterinary property owners can take to increase their property value and their wealth
- ▶ ...which can also increase your practice value

Determining Property Value: Why Does It Matter?

Refinance Property Mortgage Opportunity:

The value of your property will impact how much you can borrow and your payment interest rate.

- **Appraisal** is needed to determine the value



Property appraisals are driven by banks/lenders and are important to understand and manage:

- What valuation metrics do they use?
- How are appraisals “funky” for veterinary properties?
- How can veterinary property owners work with appraisers for higher valuations?



Determining Property Value: Appraisals

Appraisals on veterinary property vary greatly because many appraisers can be confused by the veterinary market.

They usually have ...

1

No appreciation for the stability of veterinary practices

2

No clarity on best comps (veterinary or similar buildings)

3

Not clear whether to compare "retail" or "office"

4

Relatively few veterinary property transactions

5

Relatively little experience with veterinary properties

Real Estate Appraisal



Appraisal: 3 Methods

- Cost Approach
- Income Approach
- Sales Comparison Approach



Common for an Appraisal's determined value to reflect a weighted average of all 3 methods.



Replacement Cost Approach -

Cost in today's dollars to reconstruct a similar building of a similar quality.

1

Primarily used for new construction

2

Weighed heavily for insurance purposes

Income Approach –

Rent and capitalization rate are used to determine property value. Typically used by buyers.

1

Most properties have a lease in place with an established rent

2

But is the rent set correctly?

3

And what is the capitalization rate?

Income Approach: Capitalization Rate

Relationship between the rent \$
and the property value \$.

Formula

Rent \$/Property value \$

Example

\$100,000 annual rent

\$1,000,000 property value

=10% Capitalization Rate

Income Approach: Capitalization Rate

Formula:

Rent \$/Capitalization Rate %

$$\frac{\text{Rent}}{\%} = \text{Property Value}$$

Example:

Rent	Cap Rate	Property Value
100,000/	7.5%	\$1,333,333
100,000/	8%	\$1,250,000
100,000/	9.5%	\$1,052,631

Lower Cap Rate = Higher Property Value

Capitalization Rate converted to Multiple

Formula:

1/Capitalization Rate %

$$\frac{1}{\%} \times \text{Rent} = \text{Property Value}$$

Example:

Inverse	Cap Rate	Multiple	Rent	Property Value
1/	9.5%	10.53	100,000	\$1,053,000
1/	8%	12.5	100,000	\$1,250,000
1/	7.5%	13.33	100,000	\$1,333,333

**Higher Multiple of Rent =
Higher Property Value**

Sales Comparison Approach –

Looks at the price per square foot of other “comparable” buildings that have sold recently. One method used for lender appraisals.

Problem with Appraisal method.....

1

Where is there another practice like yours?

2

And in YOUR market?

3

They are comparing apples and oranges, so they have to make adjustments

4

Appraisers have “wiggle room” for adjustments

5

Do they have the experience to see that extra value in your building?

The **TOP 2** factors of your property value are the **RENT \$** and the **LEASE quality**

Utilize a Quality Lease
(protecting the rent payment long term)

Include the **TOP 5**....

1

Longer initial term: 15 years (not including renewal terms)

2

Lease guarantor: backup plan for rent payments

3

Fewer expenses for Landlord:
Roof/structure only or absolute triple net)

4

Assignment language (only transfer of lease to a tenant of equal or greater creditworthiness)

5

Tenant required to deliver financial Reports (P&L of practice and guarantor)

Increase Property Value - Increase Lease Quality

Price Difference Based on Lease Terms	Fail To Negotiate Lease	Property Negotiated Lease
Initial Lease Term (Yrs)	5	15
Annual Rental Increases	2.0%	Greater 2.0% or Inflation
Guarantor	Individual Hospital Operation	Corporate Entity
LL Responsibilities	Structural/HVAC, Parking Lot	Roof and Structure
Right to Assign Lease	Any Affiliated Entity	Equal or Greater Net Worth
Financial Reporting	No	Practice and Guarantor
Year 1 Rent	\$80,000	\$80,000
CAP Rate	10%*	8.00%
Real Estate Value	\$800,000	\$1,000,000

** There may not be any buyer for a property with these terms. There will be no institutional buyer with these terms*



Quality Lease can **INCREASE**
PROPERTY VALUE \$200k!

Increase the Property Value - Increase Cash Flow

Good Cash flow to cover the rent

- Sufficient Profit to cover rent even if business loses revenue
- EBITDAR- Earnings before interest, tax, depreciation, amortization, rent
- Increase practice revenue and cash flow

Gross Revenue	\$2,000,000
EBITDA (12% of Gross Revenue)	\$240,000
Rent (5% – Rule of Thumb 4-6%)	\$100,000
EBITDAR (17%)	\$340,000
Coverage= EBITDAR/Rent	3.4

Minimum: 2.0
Desirable: 2.75
Strong: > 4

Increase the Property Value- Increase Rent \$

Increase the rent

- Increase the annual rent **if too low**
- Increase the rent dollars per square foot comparable with local market rent rate
- Is it still 4-6% of practice revenue
- Increase practice revenue/profit to increase rent

Rent \$	\$ per square foot for 5,000 square feet	Property Value 12.5 X Rent (8% Cap Rate)
\$75k	\$15 (Below Market Rate)	\$937,500
\$100k	\$20 (Market Rate)	\$1,250,000

Increase the Property Value- Increase Rent \$

But

- Rent needs to be in the fair market range
- Rent needs to be in the range of 4-6% revenue
- Rent needs to be affordable with cash flow
- Increases the property value **but can decrease practice value**
- Practice and Property value are tied together. Look at total impact.



Usually Real Estate multiples of RENT are higher than Practice multiples of EBITDA



Practice	Property
EBITDA Multiples	RENT Multiples
5 to 12	10.5 to 13.5

Multiple	EBITDA	Practice Value	Multiple	RENT	Property Value
10	200,000	2,000,000	12.5	100,000	1,250,000
10	150,000	1,500,000	12.5	150,000	1,875,000
	-\$50k	-\$500,000		+\$50k	+\$625,000

Total: Practice plus Property
\$3,250,000
\$3,375,000
\$125,000



Potential opportunity to increase the total value of practice plus property

*Rent was lower than fair market rent with an opportunity to increase

3 Key Factors of Property Value

1

RENT

- Is rent set close to market comps?

2

LEASE QUALITY

- Is the lease negotiated well?
- Is the tenant/guarantor credit worthy?

3

LOCATION & BUILDING

- Is the location/market strong?
- Is the building well maintained and built in the last 20 years?



Exit Opportunities for Your Veterinary Real Estate

1

Cash Transaction

- 100% or majority ownership sale

2

UPREIT Transaction



Terravet Real Estate Solutions is one of a few institutional buyers that provide Cash Transactions and UPREIT opportunities.



Exit Opportunities for Your Veterinary Real Estate

1 Cash Transaction

100% or majority ownership sale



Provides liquidity to property owner



Unlocks asset value to be reinvested in other investment opportunities



Removes the burden of lease responsibilities from landlord

Exit Opportunities for Your Veterinary Real Estate

2

UPREIT Transaction



Unique combination of immediate cash flow and long-range, tax-deferred investment potential



Diversification provided by the REIT reduces the risk compared with single property ownership



Elimination of landlord responsibilities and property maintenance costs



The ability to stay invested in the veterinary sector



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Thank You!



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