

Breaking the ground

Q&A with our experts on life sciences



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With a strong growth potential and a distinct social angle, the life sciences sector is developing at a fast pace, increasing investors' interest in securing a spot in this forward-looking niche. But access is selective, and real estate industry experience alone is not enough to be successful. What does it take? UBS Asset Management's Real Estate & Private Markets (REPM) life sciences experts Jonathan Hollick, Olivia Drew and Zachary Gauge discuss the sector's dynamics and give an outlook into what the next few years might look like.

What are the main macro-drivers behind the UK life sciences sector's growth?

Gauge: The COVID-19 pandemic undoubtedly focused attention on the life sciences sector in the United Kingdom. But even prior to the pandemic, the sector's importance to the UK economy had been growing, as the presence of leading global research institutions placed the market in a strong place to benefit from the wider macro-drivers behind the healthcare sectors.

By 2050, we'll have a larger patient base for chronic diseases. Growth in disposable incomes in emerging markets is also contributing to a larger global healthcare market, as more of the population has access to health insurance policies. Underpinning these demographic trends is a sharp increase in R&D [research and development] spending on new treatments, with global spending on R&D forecast to increase.

R&D for the life sciences sector is notoriously expensive with high failure rates, but significant progress in artificial intelligence and data-driven health solutions is accelerating advances and reducing the cost and length of trials. As the potential return on investment for R&D into new treatments has strengthened, more venture capital funding has targeted early-stage companies to support their growth, which provides the capital to fast-track early-stage companies focusing on niche areas of research into the commercialisation phase.

What makes this an attractive real estate asset class to invest in today?

Drew: There are several factors that make this

niche area worth exploring in today's market. In the United Kingdom, the clear mismatch between supply and demand of space makes investing attractive, and in our view, risk-adjusted returns can be strong, as the rental growth potential given by occupational demand is expected to outweigh supply in the near future. In addition, with the recent macro shocks to the market and the subsequent impact on the traditional real estate sectors, we see life sciences as more defensive because of this rental growth potential and supportive market dynamics. At the same time, the structural drivers discussed above by Zac, along with being more defensive with regard to the lifestyle changes caused by COVID-19 to other sectors and the social-impact angles, all add to the attractiveness of the asset class.

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With many schemes now being marketed with a life sciences angle, do you believe there is an oversupply risk?

Gauge: Since the explosion of investor interest in the sector, a large number of schemes have been put forward as potential life sciences developments or conversions. It is no coincidence that this has coincided with a difficult period for business park office buildings and the opportunity to rebrand a struggling office asset as one with life sciences potential was clear to see. But we are not expecting the bulk of these schemes to actually deliver life sciences space, for the short-medium term at least.

Office buildings do not easily convert into the

wet laboratory and manufacturing space which is in high demand. There are stringent regulations when an asset is used to handle any biohazardous material, and traditional office layouts without specialist ventilation systems cannot simply be retrofitted to provide this space. The other key constraint is location. Life sciences companies tend to operate in clusters, close to a university, hospital or key employer.

This is where many of the startups actually start their life. They develop connections with the local institutions and build their teams from the local area. So, moving a significant distance away from these clusters is rarely an option. If the proposed life sciences schemes are not part of those clusters or do not have the potential scale to reach a critical mass, then we do not see that stock as being competitive in the market.

What happened to VC funding in 2022, and do you see this as a risk to future tenant demand?

Gauge: The demand side is absolutely fundamental to the future success of real estate investment into UK life sciences, as even taking aside some of the less realistic schemes in the pipeline, there will still be a lot of new space coming through in the Golden Triangle during the next few years. The investment strategy is based on the premise that the level of occupier demand stemming from the influx of growth capital will continue to surpass the level of new supply coming through and deliver strong levels of rental growth. If that capital were to fall away, clearly this would pose a risk to the forecast levels of occupational demand to absorb the new supply coming through. Unsurprisingly, given the wider economic pressures, VC funding for UK life sciences companies has slowed in 2022 to around £1.8 billion [€2.1 billion] from £3.7 billion [€4.2 billion] in 2021. On the face of it, this may seem concerning but there are some very significant caveats.

Firstly, 2021 was by a vast distance a record year of VC funding for UK life sciences companies, and the capital raised in 2022 actually exceeded the previous peak level recorded in 2020 and was significantly above the levels that were raised between 2012–2019.

Secondly, the world is going through a significant economic upheaval that is leaving no sector unaffected – the rapid rise in global interest rates has sent shockwaves through financial markets, as they adjust to a higher cost of capital. Within the context of what is happening to other risk assets, the fact that there is still a strong flow of VC funding going into the sector during this very challenging time is quite encouraging. And finally, there is still a vast amount of pent-up demand from previous funding rounds where companies have not yet been able to find suitable real estate to expand into. What we are seeing is companies being a bit more cautious with their capital plans, as there is more uncertainty on future raises, which is resulting in slightly longer-term decision making and more cautious spending. We also consider good manufacturing practice [GMP] real estate as more

defensive in these conditions, as this is generally required by companies that are more mature and have higher company valuation and wider source of capital streams, so are less reliant on VC funding to complete their product development.

As a niche and new sector in the United Kingdom, what is the best way for investors to access the market?

Hollick: Access to this market is not easy, as the current available supply is quite limited and often controlled by institutions, which are selective in terms of whom they want to partner with or sell to. As an investor, it is crucial to show reliability, ability to deploy capital, a relevant track record, and an ability to support the wider cluster. We also feel that due to the limited amount of fit-for-purpose existing stock available today in the United Kingdom, a development-led approach is the best way to access the market. As there have been limited options available, companies and occupiers have been forced to retrofit older buildings or take suboptimal space in order to continue their operations.

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What sets UBS's expertise apart from other competitors in this space?

Hollick: Being part of the wider UBS Group gives us access to significant breadth and depth of life sciences expertise not typically available to real estate managers. Our investment bank has extensive research capabilities in the space, as well as being a market leader on the banking side, advising healthcare companies across IPOs, mergers and acquisitions, debt advisory and more. This allows us to enhance our understanding of the complexities in the space, as well as understand what drives these companies and how to analyse industry trends and growth. We also have teams focused on healthcare venture capital and private equity investing within our own REPM business, who support our team on the sector head and tailwinds and keep us informed of the funding landscape – a crucial leading indicator for the real estate market.

What are the social benefits to investing in UK life sciences real estate?

Hollick: We are now seeing major breakthroughs and rapidly improving treatment options for patients globally that are being developed across the industry. There is a shift in place

from long-term general disease management, to individualised, preventative and curative treatments. Real estate investors have a key role to play in helping facilitate the growth and expansion of this sector by providing labs and GMP space that are fit for purpose, well located and environmentally friendly.

Without the development of these facilities, there is a risk of a bottleneck in the sector without the access to space to expand. Importantly, by creating this space, we are also supporting growth in skilled employment opportunities for the local and national economy. As these facilities scale up, they require more people to operate them and to be trained across a number of skilled roles in the industry. We have worked to provide data to quantify the social impact we are having across these metrics and provide that to investors throughout the year, such as the number of skilled jobs created or the percentage of space let to SMEs.

How do you see life sciences real estate evolving during the next five years, and what developments can we expect within the sector?

Drew: We see the UK life sciences real estate market moving closer to the more mature market in the United States in the sense that it will become an established subsector within its own right. But as with the United States, the market will remain relatively niche – the very specialist nature of life sciences work will constrain it to the key cluster locations. So, it won't become a mainstream asset class in the sense of retail, office or logistics space.

Also, following the model of the US market, we expect several key developers to emerge, who have forged strong relationships with the key occupiers and institutions in the main markets, and can be relied upon to deliver the time-critical space to enable further expansion within the sector. In this regard, the market may consolidate from where it is today, in order to meet the needs of occupiers.

And we expect with further growth in the supply of life sciences real estate, the United Kingdom will enhance its credentials as a life sciences market, globally. We also believe that GMP will be an increasingly important component of the market, as the companies receiving VC funding today get closer to commercialisation and will need to have manufacturing facilities in place to progress through the clinical trials and into commercialisation.

