

# High demand, low supply for life sciences real estate

Interview with Olivia Drew, Portfolio Manager, UK Life Sciences at UBS Asset Management, Real Estate & Private Markets



**Olivia Drew**  
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## *What exactly is life sciences real estate?*

It comprises properties specifically designed and built for companies within the life sciences industry. These companies require high-specification facilities that meet their unique needs. Some of those requirements relate to aspects such as the number of air changes per hour within a laboratory, the mechanical engineering that goes in to support these types of features, the vibration criteria of the floors — considerations not typical for an office building. They can vary by different user types, whether the tenant is focused on biology, chemistry or technology. The real estate also plays a critical role in meeting the needs of these companies by providing facilities that meet, in some cases, regulatory requirements on the manufacturing side. As you can imagine, they also require significant investment. Many of the companies in the space are managing a very tight cash runway. The role of the real estate sector to provide these more specialised facilities is becoming ever more important.

## *Is there a social component, as well?*

Due to the underlying nature of the work companies are doing in this space, we think the social side of the product should be looked at in detail, and we should try to quantify that. In doing so, we've gone down two main paths. The first is the number of skilled jobs that are created by the sector. One of the key challenges for the sector at the moment is there aren't enough people working in the skilled roles as are needed. Because the sector is evolving so rapidly in areas such as cell and gene therapy, which are relatively new in the context of the wider industry, people are needing to be upskilled quickly to meet the demand coming through in those areas. Building the real estate is creating the space for these people to work, and it is also creating the demand for these people to come and work.

For example, we recently built an 80,000-square-foot manufacturing facility for a company, and that has required them to hire about 200 new staff who will be upskilled in a range of different uses for that company. We are facilitating

the growth of skilled work and working with our occupiers to ensure they are using the resources in the local community to benefit the areas they're in.

The second way we've looked at the social impact is the companies in the space are doing research that has a positive effect on human health and patient outcomes. But the ability for them to do that R&D [research and development] is significantly assisted by quality real estate developed to the right specification and in the right location. Real estate has an important supporting role to play in the end goals of the underlying companies, in terms of patient outcomes.

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## *What about on the environmental side? Is it true that labs and manufacturing facilities are more energy intensive than offices?*

That is true. An average office has one or two air changes an hour while a laboratory can have anywhere from six to 12 air changes an hour, and a manufacturing facility needs up to 30 air changes an hour. Manufacturing in the life sciences sector does not require large-scale, industrial manufacturing facilities, though. This manufacturing requires small bioreactors or production methodologies that don't have that same massive environmental impact that some of the more traditional manufacturing facilities have. We work very hard to mitigate the environmental impact, ensuring we have no requirement for gas boilers, that we have heat pumps, solar panels on the roof and sustainable water drainage. All of these are mitigations you can apply in an office building, but significantly mitigating the environmental impact is equally as possible for a laboratory and even a manufacturing building, which is much more energy intensive.

### *What would you say makes this an attractive real estate sector to invest in today?*

There are a number of headwinds for investors in some of the more traditional sectors, be they the ongoing implications of work-from-home, oversupply in certain sectors or obsolescence due to rising sustainability requirements. With life sciences, particularly in the UK and Europe, many of the facilities don't yet exist today, and so we have a very strong level of demand but very little supply. That supply/demand imbalance is very supportive of rental growth in the sector, while traditional sectors are not indicating the prospect of rental growth as strong. Particularly when rates and exit yields are more challenging, gaining return through income growth is attractive for real estate investors. Equally, sustainability themes are important for investors, and the life sciences sector is able to meet a lot of those expectations, both on the social side and on the environmental side.

### *One thing we hear is demand is concentrated in just a handful of markets. Is that concentration a macro theme within life sciences?*

It is true these clusters exist, whether in the US or Europe. There is inherent value in the location you're in, and it's very difficult to just pick a new location and start from scratch. That location-specific value is supportive of your investment value and your real estate, and it slightly mitigates the risk around supply and demand. The US has some markets now that are struggling from oversupply, which was probably exacerbated by trends in the capital markets, which will take time to shake out and return to a dynamic of rental growth and lower vacancy.

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

First, we're going to see more supply, and at the moment, life sciences companies, particularly in the UK and Europe, have very little choice about where they can go. Companies are having to take retrofitted office space or industrial space that's not optimal. As more supply comes into the market, we'll start to see companies being able to pick and choose properties, and we'll see the impact of that on locations.

Second, we'll see more comparability with the more mature US market. Investors in US life sciences assets have a lot more data they can use to analyse demand, take-up and specification. In the UK and Europe, there is not enough data to look at schemes on a side-by-side basis and underwrite them. As we start to see that market mature and more data come through, we'll be able to compare investments more easily, which might start to impact investor decision making. We'll see more manufacturing space coming into the market. That's inevitable with the amount of R&D space that is being developed. It's great that so

much investment is going into the R&D side, but if we want these medications to be developed and given to patients, they need to be manufactured at scale. I think there will be more focus on the GMP [good manufacturing practices] side in the medium term and also more focus on the environmental side, including further developments to help to support the environmental accreditation of the buildings. Because of the rush to provide facilities and the demand from companies during the past few years, environmental issues in some schemes may not have taken centre stage. But I think, going forward, as tenants are going to have more choice, sustainability is going to come up higher on the agenda for life sciences like it has in the office space.

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### *Sustainability is a growing theme. But you have these property types that make it harder to manage. What is the best way for investors to access the life sciences market?*

There is broad agreement the life sciences sector is exciting. But for institutional investors, real estate is a lower risk route to get exposure. If you invest into the underlying companies themselves, you have to have a lot of specialist knowledge, and there is risk that goes into investing in an early-stage company because of the drop-out rates in this sector. You may like the fundamentals of the sector and look at the growth trajectory of it, and if you're looking for a way to capitalise on that, we think real estate is a good way to do so because your investment is secured against the asset itself. We view labs, and particularly manufacturing facilities, as infrastructure for the sector, and they don't have to be bespoke to any one tenant. You can be diversified across the sector just by owning quality real estate because if one tenant uses it and is no longer able to use it, you can relet that space to another occupier in the sector.

### *As the influence of life sciences grows, more locations are catering to the industry needs. What are the main emerging hubs?*

The story has played out already in detail in the US, and those clusters are well known. In the UK,

there is the Golden Triangle of Cambridge, Oxford and London, which is internationally recognised because of the strength of the universities, the R&D work and the hospitals. This area has taken the lion's share of life sciences investment that comes into the UK. A theme we'll likely see during the next few years is that other UK areas will continue to develop into areas of excellence. We see that already happening in a number of areas in the north of England and in Scotland. While that trend will continue to play out, the Golden Triangle will likely retain its majority share due to the depth of the market and its connectivity into Europe and the US.

The European Union is a broader conversation because of the number of countries and competing clusters. It is harder to pick a cluster because the market is in an earlier stage. We see a huge amount of potential across the Netherlands, Germany, France and Switzerland, and also in Belgium. Those markets will be a focus for us, and we see more emerging clusters coming up in some of the other countries, as well.

The three key elements that comprise a successful cluster are the academic environment, hospitals and pharmaceutical companies. Those have traditionally been spoken about as the key drivers of a successful cluster. But people are recognising the skilled workforce availability is another key driver. That has traditionally overlapped with where large pharmaceutical firms have had a presence. On the manufacturing side, you also need to account for availability of space and infrastructure and logistics, as well as servicing.

### *What are the differences among the global life sciences real estate markets, and where are they the most advanced?*

The US is the most advanced market on the real estate side. And the provision they have across a number of clusters, both on the East and West Coasts and creeping inland, as well, established the US as the key market to be in, enhanced by the strength of the academia, the ability to commercialise product and the insurance payer model. Other areas in Asia and the UK probably follow, and then Europe probably lags slightly behind. That is broadly the map as it relates to density of clusters. There are also different levels of government support and tax incentives that determine how attractive it is for companies to locate in a market, do research there and commercialise product there. Finally, another distinguishing factor is the regulatory framework that determines how easy it is to run your clinical trial in that jurisdiction.

