

Life Sciences beyond borders



High interest rates, cooling venture capital and an oversupplied market – will the UK follow the path of the US Life Sciences real estate market?

Definition: Life Sciences Real Estate

For the purpose of this article Life Sciences is defined as an industry that is comprised of companies involved in the research, development and manufacture of pharmaceutical, therapies and medical devices, which help to foster medical innovations with the ultimate aim of extending the length and quality of human life. Life Sciences real estate is property specifically designed and built for companies within the industry.

Life Sciences hits reset in a year of global headwinds

2023 was a year of prolonged high inflation, sharp interest-rate hikes and a weak economy, with looming fears of recession. Most countries, however, proved resilient and avoided recession. Now, as most markets can see disinflation and signs of interest rates at their peak, there may be light at the end of the tunnel and a path to improved market conditions in 2024.

Whilst the Life Sciences real estate sector has traditionally remained resilient to challenging economic environments, it is not immune. A year of economic headwinds combined with continued challenges from geopolitical tensions has resulted in a large-scale market correction across all asset classes. Although we think the bulk of the correction occurred by the end of 2023 in the UK, we expect capital values to continue to bottom out in 2024.

Of course, not all markets, geographies or sectors in real estate are equal. The US has always been a bellwether for the UK market, even if the UK market is dwarfed by the USD 774 billion US Life Sciences market. Similarly, to the rest of the global real estate industry, both the US and UK

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Life Sciences markets have faced a challenging year. Despite the UK traditionally following the trends of the US, we see the two markets in markedly distinct positions going into 2024.

2023 – a challenging year: US vs UK Life Science Markets

Life Sciences companies were forced to do more with less in 2023. The US leasing and real estate capital markets felt this pull back just as new life sciences supply was delivering at scale to the market. The US market, the largest in the world, contains 193 million square feet of R&D lab space with another 38 million under construction. The top three US markets of Boston, San Francisco and San Diego account for a combined 117 million square feet, or 61% of all lab space in the US. These three markets are contributing 75% of the new supply pipeline, indicating that they are increasing their already dominant share of the Life Sciences real estate market. 2024 will serve as the peak supply year in the US. Speculative construction has slowed materially as debt markets retracted, construction costs peaked, vacancy rates hit between 6-12%, supply rose, and

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Life Sciences companies moderated expectations and sidelined real estate expansions in favor of capital preservation.

Venture capital funding in the US, was below record pandemic levels but surpassed 2019 at just under USD 25B in 2023. The top 3 markets received 67% of that funding in 2023 vs 58% in 2019, while secondary and emerging markets saw their share of funding decrease. Fewer funding rounds closed, but those that did were for larger amounts and typically with later stage companies with strong data supporting their science. Sentiment is turning cautiously optimistic in the early days of 2024 and venture capital funds are sitting on significant dry powder.

The ratio of new supply compared to tenant demand has put downward pressure on net

effective rents and landlords have been forced to increase capital in the form of fully built lab suites or larger tenant incentives to accommodate cash strapped biotechs. Whilst still at historically elevated levels, the ratio of new supply compared to tenant demand began to improve at the end of 2023 and into early 2024. Rental rates have pulled back from their 2022 historic peaks, though a floor appears to be forming in many markets. These factors will serve to incentivise sidelined tenants to act on their real estate needs as the traditional funding sources open up in 2024 and beyond and demand for Life Science real estate begins to normalize. For the time being, the fundamentals are leaning favorably toward the tenants, but the market will seek equilibrium.

The UK leasing and real estate capital markets felt a pull back from Life Sciences companies, but crucially this did not coincide with a peak of supply. Throughout 2023, the UK supply market remained tight, with nearly all standing stock accounted for, with vacancy rates around 1-3%. Compared to the US market, the UK has a total of 30 million sq ft of R&D space. The top three UK markets, otherwise known as the ‘Golden Triangle’, Cambridge, Oxford and London, account for a combined 15 million feet or 50% of all lab space in the UK. These three markets account for over 90% of new supply, like the US demonstrating the dominance of these markets in terms of real estate market share. However the key differentiator for the UK is that the supply pipeline, moderated over 2023 now has a 2 year time lag for peak supply. Over the past year, the supply pipeline has contracted significantly, responding to rising inflation, valuation shifts and construction costs combined with a more constrained occupier base slowing down their real estate expansion plans.

Venture capital, similarly to the US, faced decline; however, this was more moderate compared to the US. When compared to average pre-pandemic levels (2015-2019) of GBP 2bn, 2023 was forecast to finish well at GBP3.7bn reflecting a long-term upward trend. The Golden

Triangle received just under half of all UK funding in 2023. Deployment followed a similar path to the US, with extended time periods to receive funding and many occupiers turning to bridge financing options, and with average ticket sizes that were smaller compared to past years.

Therefore, unlike the US, the continuing supply/demand imbalance in the UK has meant that we have not seen the same downward pressure on net effective rents. In fact, rental growth continues to take place across the markets, as occupiers struggle to find fit-for-purpose space. 2023 saw the UK Life Science real estate market move more slowly, but as sentiment warms, we expect the market is poised for an upward trajectory.

Resilience in Life Sciences: Emerging strong from the downturn

The Life Sciences sector has long been on a strong growth trajectory globally, even prior to

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the COVID-19 pandemic, as illustrated by the demand and supply drivers outlined below.

The global economic downturn that followed in the wake of the COVID-19 investment craze resulted in an abrupt market correction for the Life Sciences real estate market, most notably in the US. However, a testing economic market does not remove the need for further medical research and scientific innovations to combat global population health challenges. FDA approvals of novel drugs and therapies were at an all-time high in 2023,

Strong macro drivers for life sciences predated COVID-19

Technology & discovery

AI and data-driven health solutions are accelerating advances in R&D and reducing the cost and length of trials

Funding growth

Investment into the sector has grown steadily in recent years, notably Venture Capital which has provided capital to supercharge growth from early-stage companies

Expiring patents

Expiring patents require a continued flow of funding for R&D to replenish protected treatments

Supportive demographics

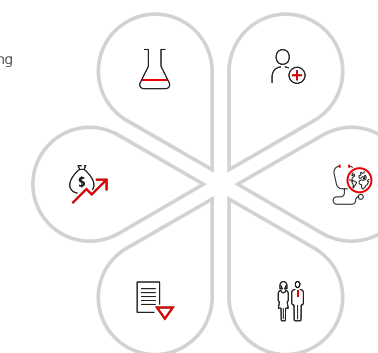
Demand for the life science sector continues to be driven by an aging population (larger base of chronic diseases), along with growing disposable incomes in emerging markets, increasing the proportion of the global population with access to health insurance policies

Unmet medical need

Currently, over 90% of known rare diseases have no available treatment – driving the life sciences industry on a non-cyclical basis

Rising healthcare spend

Healthcare spending in developed markets has consistently increased as a share of GDP



Source: UBS Asset Management, Real Estate & Private Markets (REFM), December 2023





Property CGI of proposed scheme, Oxford, UK

with fifty-five approvals and the first ever CRISPR drug approved. The remit of scientific preventative measures and cures continues to expand, demonstrated most notably by recent blockbuster obesity and diabetes drugs that work to combat the growing obesity crisis.

While near-term headwinds and uncertainty persist, both US and UK markets are showing signs of cautious optimism and warming sentiment. A recalibrated real estate supply combined with a poised investment market sees a brighter outlook for 2024 for both the UK and US Life Science markets. Looking back over the last few years, two key lessons can be taken for both the Life Science industry and the real estate that accompanies it. Firstly, the year of COVID-19 was a year of over-investment. When faced with a global pandemic and record high

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research and development the investment market reacted. Going into 2024 the funding market will normalise for both US and UK markets and with this will come more considered Life Science company expansion.

Secondly, location and quality matter. Life Sciences real estate will continue to perform provided it is in the right location and providing the right product. The flight-to-quality that is unfolding in the traditional office sector will replicate in UK and US Life Science real estate. Well-located projects in the strongest clusters, with a thriving ecosystem and amenities that enrich the occupier’s experience and offer a clear path to growth will be best suited to capture future demand. Landlords that focus on the product and experience so that occupiers can focus on their science will win the day.

The global market correction has come at a critical moment for the UK Life Science real estate market and allowed the supply pipeline to adjust and rationalise. The UK therefore does

not face the same issues of oversupply that the US does. Whilst global near-term headwinds and uncertainty persist, sentiment is now improving, and 2024 is already providing evidence of a strengthening market, with a number of IPOs and key financings being announced. AI will help to drive efficiency and innovation in research. Cash-rich global large pharma companies will continue to bolster and source their R&D pipeline through

M&A. VC dry powder will be deployed. Interest rates will stabilise, and companies will have more predictable financing options. The IPO market will return, cautiously. Opportunities remain for new companies with the right combination of science and capital. The wave of new real estate supply will be absorbed, in some markets more than others. The biggest clusters will get bigger. Strength begets strength.

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Delivering innovative solutions in private markets



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