Top 10 with…

Interview with our experts on life sciences

December 2022 – **Approved for global use ex US**

Key facts for life sciences:

2021

new strategy established

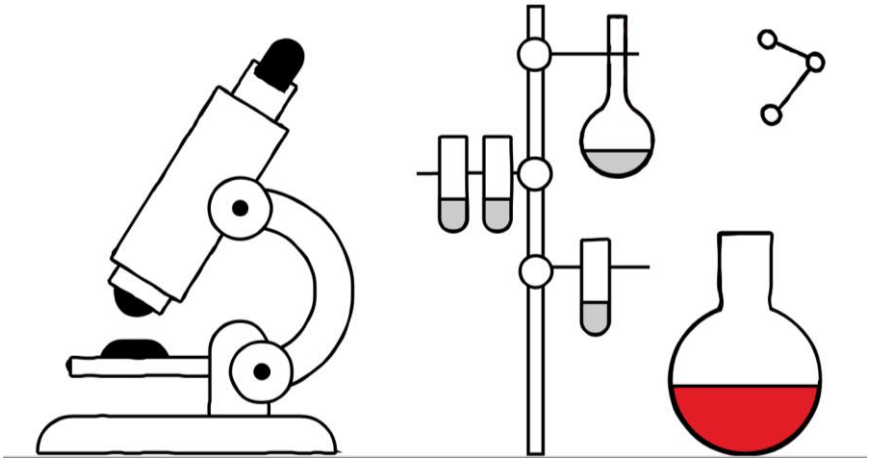
GBP 2.4bn

of gross development value (GDV) already secured*

182,802 m^2

Investment target for R&D space**

Source: UBS Asset Management, Real Estate & Private Markets (REPM)
* Data as at September 2022
** Data as at August 2022



Breaking the ground

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 industry expertise isn't enough to be successful. What does it take?

UBS Asset Management, 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.

Our experts

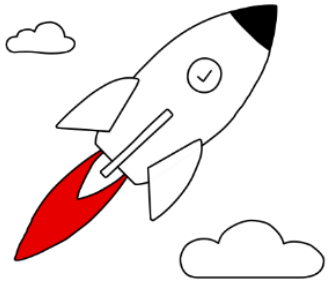
Jonathan Hollick
Head of Real Estate Europe ex DACH

Olivia Drew
Portfolio Manager, UK Life Sciences

Zachary Gauge
Head of Real Estate Research & Strategy – Europe ex DACH

As an investor, it's crucial to show reliability, ability to deploy capital, a relevant track record, and an ability to support the wider cluster.

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

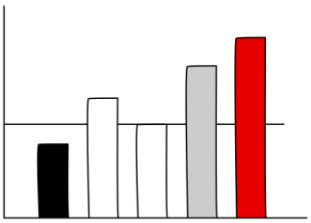


Zachary Gauge:
The COVID-19 pandemic undoubtedly focused attention on the life sciences sector in the UK. But even prior to the pandemic, the sector's importance to the UK economy had been growing as the presence of leading global research institutions placed the market in a strong place to benefit from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

By 2050, 16% of the world's population will be over 65, versus 9% in 2019[1], creating 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 & development) spending on new treatments, with global spending on R&D forecast to increase from USD 200 billion in 2020 to USD 250 billion in 2026[2].

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 are 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 (VC) 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 commercialization phase.

2 Where does the UK sit compared to other global life sciences markets?

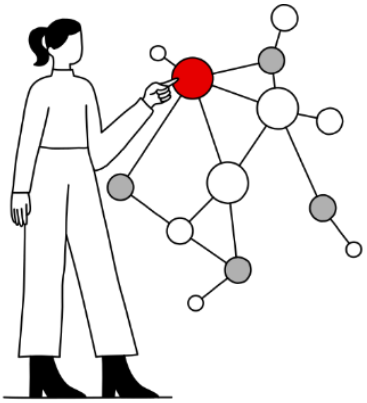


Zachary Gauge:
Using biotech financing as an indication of market size, the UK is the third largest market attracting GBP 4.5 billion of investments in 2021 and half of all European biotech venture capital[3].

The US remains by far the largest global market, but in a congested market funds have increasingly looked overseas for new funding opportunities. The UK has a relatively unique feature within a European context which is the clustering of three key knowledge hubs in Oxford, Cambridge and London which forms the Golden Triangle.

This well-connected region contains four of the top 10 global universities, and the clustering of academic excellence in one region, has acted as a major draw for VC capital entering the European market for the first time. When the three markets are combined, it is the third largest recipient of VC funding after Cambridge Massachusetts and Shanghai[4].

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



Olivia Drew:
There are several factors which make this niche area worth exploring in today's market. In the UK, 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. It's also worth noting that 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.

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

Zachary 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.

A big part of our confidence here is that 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 start-ups 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 aren't part of those clusters or don't have the potential scale to reach a critical mass, then we don't see that stock as being competitive in the market.

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

Zachary 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 over 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 was 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, funding into UK biotech companies fell to GBP 931 million from GBP 2,38 billion in the first half of 2021[5]. 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 funding for UK biotech companies, and the capital raised in 1H22 was only slightly below the volume raised in 2020 and significantly above the levels that were raised between 2012-2019.

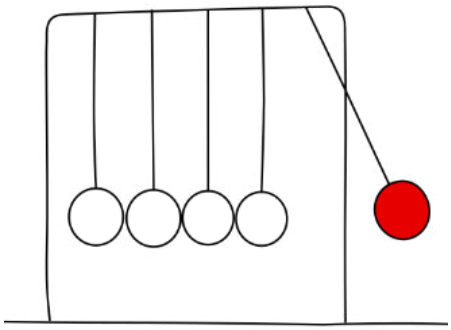
Secondly, the world is going through a significant economic upheaval which is leaving no sector unaffected – the rapid rise in global interest rates has sent shockwaves through financial markets as they adjust to a higher cost of capital. Within the context of what is happening to other risk assets, the fact there is still a 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 which are more mature and have higher company valuation and wider source of capital streams, so are less resilient on VC funding to complete their product development.

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

Jonathan Hollick:
Access to this market isn't easy, as the current available supply is quite limited and often controlled by institutions which are selective in terms of who they want to partner with or sell to. As an investor, it's 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 UK, a development-led approach is the best way to access the market. As there has been limited options available, companies and occupiers have been forced to retrofit older buildings or take sub-optimal space in order to continue their operations. Assets like these have the potential to become obsolete as the market evolves. We think there is a real opportunity to develop ground up, to create future proofed smart buildings that offer occupiers what they need both today and into the future.

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



Jonathan 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, M&A, 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 analyze 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 tail winds, and keep us informed of the funding landscape – a crucial leading indicator for the real estate market.

8 Labs and manufacturing facilities demand higher energy usage than typical office or retail buildings. Can they be environmentally friendly?

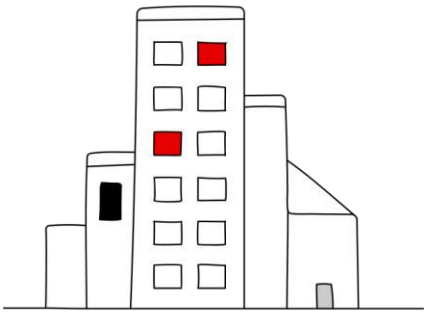
Olivia Drew:
It's true that these facilities are energy intensive, and it's also true that the specification and construction techniques for these facilities are rapidly evolving. It was really important to UBS moving into this space to make sure the facilities we constructed could still meet key environmental standards. We have found that it's certainly possible to enable these buildings to be both constructed and operated in an energy efficient manner. A few examples include our GMP facilities having no gas boilers but using heat pumps and having a significant amount of PVs on the sites. What's important to note is that as a landlord, we can enable the buildings to be energy efficient, but ultimately the tenant is in control of the operation, and hence tenant engagement remains key to keeping these buildings green.

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

Jonathan Hollick:
The social benefits for the life sciences sector are clear to see with the major breakthroughs and rapidly improving treatment options for patients globally that are being developed across the industry. We're seeing a shift from long-term general disease management, to individualized, 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's 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 look 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.

10 How do you see life sciences real estate evolving in five years-time and what developments can we expect within the sector?



Olivia Drew:
Over the next five years we see the UK life sciences real estate market moving closer to the more mature market in the US in the sense that it will become an established sub-sector within its own right. But as with the US, 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, that the UK 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 commercialization and will need to have manufacturing facilities in place to progress through the clinical trials and into commercialization.

1 Savills Science Cities; February 2021. **2** Evaluate Pharma; World Preview 2021. **3** UK BioIndustry Association; January 2022. **4** Savills; UK Science Real Estate – The Occupier Perspective; May 2022. **5** UK BioIndustry Association; May 2022

For more information, please contact:

UBS Asset Management
Real Estate & Private Markets (REPM)

Bahnhofstrasse 45
8001 Zürich
Switzerland
Tel: +41-44-234 11 11

Follow us on LinkedIn

To visit our research platform, scan me!

www.ubs.com/realestate

UBS