



Life sciences beyond borders: The UK versus US life sciences markets

*High interest rates, cooling venture capital and an oversupplied market –
Will the UK follow the path of the US life sciences real estate market?*

The definition of life sciences real estate

For the purpose of this article, life sciences is defined as an industry that comprises companies involved in the research, development and manufacture of pharmaceuticals, 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.

While 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 United Kingdom, 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 market has always been a bellwether for the UK market, even if the UK market is dwarfed by the \$774 billion (€725 billion) US life sciences market. Similarly to the rest of the global real estate industry, both the US and UK life sciences markets have faced a challenging year. Despite the United Kingdom traditionally following the trends of the United States, we see the two markets in markedly distinct positions in 2024.

2023 was a challenging year: US vs UK life sciences 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 (18 million square metres) of R&D lab space, with another 38 million (4 million square metres) under construction. The top three US markets of Boston, San Francisco and San Diego account for a combined 117 million square feet (11 million square metres), or 61 percent of all lab space in the United States. These three markets are contributing 75 percent of the new supply pipeline, indicating they are increasing their already dominant share of the life sciences real estate market. 2024 will serve as the peak supply year in the United States. Speculative construction has slowed materially as debt markets retracted, construction costs peaked, vacancy rates hit between 6 percent and 12 percent, supply rose, and life sciences companies

moderated expectations and sidelined real estate expansions in favour of capital preservation.

Venture capital funding in the United States, was below record pandemic levels but surpassed 2019 at just under \$25 billion (€23 billion) in 2023. The top three markets received 67 percent of that funding in 2023 versus 58 percent 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 with 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 biotech firms. While still at historically elevated levels, the ratio of new supply compared with 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 traditional funding sources open up in 2024 and beyond, and demand for life sciences real estate begins to normalise. For the time being, the fundamentals are leaning favourably towards 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 percent to 3 percent. Compared with the US market, the United Kingdom has a total of 30 million square feet (2.8 million square metres) 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 square feet (1 million square metres) or 50 percent of all lab space in the United Kingdom. These three markets account for more than 90 percent of new supply, like the United States demonstrating the dominance of these markets in terms of real estate market share. The key differentiator for the United Kingdom, however, is that the supply pipeline that moderated during 2023 now has a two-year time lag for peak supply. During 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 faced decline, similar to the United States; however, this was more moderate than in the US market. When



Property CGI of proposed scheme, Stevenage, in the United Kingdom

compared with average pre-pandemic levels (2015–2019) of £3.7 billion (€4.3 billion), 2023 was forecast to finish well at £3.7 billion (€4.3 billion), 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 that of the United States, with extended time periods to receive funding and many occupiers turning to bridge financing options, and with average ticket sizes that were smaller compared with past years.

Therefore, unlike in the United States, the continuing supply/demand imbalance in the United Kingdom has meant it has 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 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 the COVID-19 pandemic. Structural demand drivers, such as an ageing population, growing middle classes in emerging markets and increased access to health insurance globally, have been developing. Alongside these changes, supply factors, such as significant advancements in technology and therapeutics, with developments in artificial intelligence and machine learning, plus increased private and public investment, are driving the sector forwards. 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 United States. A testing economic market, however, 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, with 55 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.

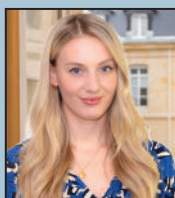
While near-term headwinds and uncertainty persist, both US and UK markets are showing signs of cautious optimism and warming sentiment. A recalibrated real estate supply, combined with a poised investment market, sees a brighter outlook for 2024 for both the UK and US life sciences markets. Looking back over the last few years, two key lessons can be taken for both the life sciences industry and the real estate that accompanies it.

Firstly, the year of COVID-19 was a year of overinvestment. When faced with a global pandemic and record-high 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 sciences 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 unfolding in the traditional office sector will replicate in UK and US life sciences 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 who focus on the product and experience so occupiers can focus on their science will win the day.

The global market correction has come at a critical moment for the UK life sciences real estate market and allowed the supply pipeline to adjust and rationalise. The United Kingdom, therefore, does not face the same issues of oversupply that the United States does. While 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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