



Navigating growth

Underlying trends are creating attractive opportunities in the European life sciences real estate market

The life sciences industry and its real estate demand are on the rise. Thus, real estate focused on meeting the increasing needs of this part of the economy represents an attractive risk-adjusted investment opportunity for value-added and core investors alike.

Good manufacturing practices and real estate

The life sciences industry's real estate demand goes beyond the traditional office or pharma manufacturing site. The processes within the sector call for specialised real estate, e.g. labs with secure water-waste treatment, rapid air circulation and change, or reinforced floors to meet maximum vibration criteria to maintain good manufacturing practices (GMP).

GMP ensures that products made for patients, for example, are produced in a consistent and controlled manner, following strict quality standards. One of the core components of GMP is *premises*, which includes standards a building must meet if it is to be used for research and development (R&D) or manufacturing of a pharmaceutical product, for instance. Multiple countries have adopted GMP as a core condition for companies in the life sciences industry, forcing them to find buildings that are of adequate standards to meet the premises component of GMP. In many markets, those buildings are in short supply.

Demographics and rising income drive long-term demand

Increases in the demand for products and services made by the life sciences industry are likely to drive demand for life sciences real estate assets. This includes companies seeking premises to conduct R&D, manufacturing and other support processes to meet said demand.

On the macro level, there are two important drivers for the life sciences industry (and its demand for life sciences real estate). For one, the demographic development shows the key age group that is the primary consumer of life sciences products – i.e. 65 and above – is growing at a much faster rate than the working-age population,¹ creating a long-term growing demand for its products. Another important factor that drives the demand for life sciences products is the fact that the world's population is getting wealthier. Wealthy societies allocate a higher share of their income to purchase health services than mid- and low-income nations.²

Within the life sciences industry are also interesting trends that are likely to shape its trajectory and its real estate leasing demand in the years to come. These include the validation of mRNA³ vaccines, increased use of artificial intelligence (AI), and geopolitical uncertainties driving companies towards building manufacturing capacities closer to the end consumer.

ESG requirements in life sciences

It should be noted that environmental, social and governance (ESG) factors are a focus in the life sciences industry, particularly its carbon footprint. As an example, as of end of April 2024, more than 110 life sciences companies had set themselves near-term

targets to reduce their carbon footprint via the Science Based Targets Initiative (SBTs).⁴

Life sciences companies will require the real estate assets they occupy to be of high quality, especially in terms of energy efficiency and (operational) carbon footprint. It is crucial that any space developed to meet the life sciences industry's specific requirements will also be able to meet its need for energy-efficient and carbon-light premises.

The European life sciences landscape

There are multiple bioscience clusters in Europe at a different stage in their development.⁵ *Advanced clusters* are primarily found in the United Kingdom, which is at the forefront of the European life sciences industry. Here, the Golden Triangle (London, Oxford, Cambridge) is a world-leading, top-tier science super-cluster: academic links are strong, the number of companies is high, and their diversification across different specialism within the life sciences industry is vast. In addition, the funding environment is deep and diverse, talented professionals are many, and the location has the appropriate type of premises (real estate space). Berlin-Potsdam and Paris are advanced clusters, as well.

Established clusters are hubs that have proven themselves to be relatively diverse and resilient in nature, but their size – in terms of academic and other research centres, companies, financing, professionals or appropriate premises – is lacking in comparison with advanced clusters. Those hubs may be renowned for a broad-scope research specialism, but the offshoots from that research may still be few or narrow. There is room for growth and further variety within established clusters, which would increase the volume and diversity of activities in the sector and its resilience to outside shocks, such as an economic downturn or a slowdown in R&D financing. Examples include Stevenage in England, Amsterdam and the greater Zurich area.

Emerging clusters may be growing relatively fast around new pioneering technologies. They are still uncovering their specialism, however, and the diversity of different R&D and manufacturing activities is still low. Many of these clusters are still vulnerable to outside shocks.

The opportunity for real estate investors

First, macroeconomic tailwinds are working with investors exposed to the industry. This includes real estate investors that can offer premises to a defensive industry that is looking at relatively fast underlying growth for its products.

Second, tailwinds within the industry are driving its real estate footprint in Europe towards more varied premises, ranging from lab-enabled offices to wet-lab space and manufacturing, and logistics and manufacturing hubs intended to serve regional demand for life sciences products. Those assets are today in short supply, giving value-add investors the opportunity to move first into clusters where the growth versus risk trade-off is the best.

Advanced clusters, meanwhile, offer both core and value-added investors the chance to gain exposure to a location that is ripe with talent and where the capacity of the clusters to integrate new technologies into existing processes is strong. All this demands the right amount of and the appropriate types of real estate space.

Third, the industry's strong ESG focus creates first-mover advantages for real estate investors capable of meeting not only the industry's underlying and shifting demand for premises, but also its requirements for energy efficiency and a light carbon footprint. Being the first to supply ESG-focused premises to the rising number of companies in the sector that want to focus on energy efficiency and their carbon footprint can be a competitive advantage in the leasing market, especially as those assets are in short supply.

Fourth, real estate investors should be able to find attractive risk-adjusted opportunities across both core and value-add strategies. Core investors should focus on energy-efficient buildings to avoid stepping too far out on the risk curve where they need to allocate funds to meet energy- and carbon-focused capex projects in the future. They should primarily focus on advanced and established life sciences clusters and seek tenants in the SME- or corporatesize brackets in order to de-risk the asset and limit necessary asset management activities.

Value-added investors have a freer range and may take on different types of risk. They can accept carbon-capex needs by targeting existing assets with short leases, generating value by upgrading the buildings and re-offering them into a leasing market with strong demand fundamentals. They may also choose a more ground-up approach and work with joint venture partners (developers) that are best fit to carry the development risk in markets where the sectoral tailwinds are transforming the forest to a more diverse set of companies.

Value-added investors need to keep a close eye on the sectoral tailwinds in the industry and how those winds build up and transform the leasing demand for different types of premises that life sciences industry needs. Value-added investors also need to keep an eye on construction costs, especially since many life sciences premises demand a higher-standard finish than the usual logistics or office space, for example. This may increase construction costs compared to more standard buildings.

Things to consider

It is important to note that, despite the leasing fundamentals of the real estate life sciences sector looking attractive, *there's many a slip between the cup and the lip*.

First of all, the real estate market in its entirety has been hit hard by rising interest rates, which has directly affected real estate values. Higher rates can also affect the short-term dynamics in the leasing market via companies' planned capital expenditures and other investments into production capacity. This includes real estate space. There are signs this effect has now mostly run its course, but that is outside the scope of this article.

Second, the sector is less known than other major real estate sectors, such as offices or logistics. It is also not as transparent, for it is in its infancy. Investors, therefore, must be careful to select asset managers with good experience, contacts and knowledge within the sector in order to control their risks. Idiosyncratic risks on the asset level can be very high in the sector compared with, say, logistics: A logistics building is usually a standardised shell with few complicated specs, while a life sciences property may be subject to various and stricter building regulations.

Last, but not least, selecting the right clusters to invest in is crucial and must meet the investor's risk preference. The advanced clusters are diverse and have liquid leasing markets that reduce the real estate investor's asset management (leasing) risk. They are also the most liquid life sciences clusters in capital markets. Established clusters have a greater growth potential but are not as liquid, neither in leasing markets nor capital markets. Finally, emerging clusters are high-risk and, potentially, high-return locations that should be treated as long-term investments. There are also multiple outside factors in the last segment that may not be under the investor's control, e.g. influential government regulations or municipality zoning rules that may affect the development potential of a cluster.

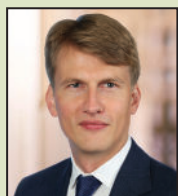
Who dares, wins

The life sciences sector is a defensive, growing sector that focuses on improving lives. To be able to grow and enable the transformative forces within the sector to take place, the appropriate amount and type of real estate assets must be available and provided.

Those assets are, today, in short supply. Therefore, real estate investors have an important task and an opportunity ahead of them, potentially ripe with first-mover advantages, that can provide them with attractive risk-adjusted returns over the medium to long term.

Notes: ¹ World Bank, 2023; ² World Bank, 2023; ³ Messenger RNA (abbreviated mRNA) is a type of single-stranded RNA involved in protein synthesis; ⁴ sbti.org; ⁵ JLL, EMEA Life Sciences Industry & Real Estate Perspectives, 2024

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* Assets under management stated on gross asset values basis and includes CS, reflecting values as of 31 December 2023, where available.

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