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LIFE SCIENCES EXPERT REACTION FINANCE UK & IRELAND

Funding the life sciences boom - the lender's view

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Financiers need to consider a range of factors when deciding what schemes to back

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The property market has roared back to life post-Covid and is broadly exceptional, but some real estate sectors have been irreparably hit. This

has prompted creativity among investors and developers to focus on underlying land values and conversion potential in order to reap the benefits of emerging trends.

One of the sectors sparking significant investment is life sciences. Investors' interest was piqued by the pandemic and the ongoing demand for critical cancer, gene therapy and immunology research has made it a chronically undersupplied and rapidly growing market.

Savills reported in November last year that every €1bn of VC investment creates 46,000 sq m of life science real estate demand. Therefore, the €10.2bn of capital invested during 2019 and 2020 indicates approximately 474,000 sq m of new requirements from the life sciences sector will emerge in 2022.

Apollo is buying Leonardo's Edinburgh campus in part due to its life sciences angle

Yet lab builds have very specific and costly requirements which are often bespoke, and micro-location is absolutely critical, leaving developers with a limited tenant base for the long term. Finance from traditional lenders is also unlikely to be an option in the short-to-medium term. So, what's the attraction and where are the pitfalls and the potential?

Much of the sector's appeal is based on rapidly rising numbers of R&D staff. The UK has 250,000 workers in this sector in 6,300 businesses contributing £81bn of turnover to the economy. The sector is resilient to the current mode for homeworking due to requirements for equipment and optimised environments.

Financing undoubtedly requires a specialist lender with market knowledge, able to evaluate key factors to underpin the loan such as site location, likelihood of consent, the track record of the borrower, potential conversion or build difficulties and fallback scenarios

Lenders will look at occupancy levels and lease uptakes but find a lack of available data, making a metric-driven approach challenging. For example, life sciences data is often merged into office data, and current data shows that uptake for leases has actually fallen. This is in fact only due to the lack of suitable stock, not for lack of demand.

As previously referenced figures suggest, the huge increase in VC funding to small start-ups has fuelled demand. These companies often carry out mission critical research and need lab space immediately and on short leases as future funding will undoubtedly not have been secured.

Conversion complications

With such a fast pace of change and urgency, office to lab conversions are becoming popular but may be problematic. Requirements include minimum floor loading levels and ceiling and window heights, plus very specific needs such as increased ventilation, gas storage, waste handling and back up generators.

Lenders would certainly be looking at fallback scenarios, particularly where planning has not been achieved, to ensure that the loan is underpinned by the existing use value of the site. Possibilities include shell and core fitout with an option for the tenant to personalise their own space.

Dry labs also have fewer requirements than wet. Future proofing is key as many tenants will take short leases, thus longevity in design is crucial. Developers would be wise to seek feedback from a prospective tenant base.

Canary Wharf Group is aiming to make its estate a hub for life sciences

In the UK, life science developments have focused around the so-called “golden triangle”, incorporating Oxford, Cambridge and London. Some 75% of VC funding for life sciences went to companies in the golden triangle in 2021.

Clusters are considered vital to attracting leading academic talent and creating business synergies and knowledge gateways. Therefore, landlords and developers with a series of buildings in close proximity have the opportunity to create an exciting vision for a tech cluster, but attracting the right tenants for a successful ecosystem and delivering the right product are both key.

London is dominant in the sector, ranking amongst the best in the world, but suffers a shortage of space with currently only around 10,000 sq m of lab space. Clusters include White City, King’s Cross and Euston Road,

plus initiatives including the Whitechapel Life Science Masterplan led by a partnership between Queen Mary University, the Royal London Hospital and Barts Life Science, which is expected to deliver in excess of 100,000 sq m of lab-enabled space over the next five to seven years.

Ask recently lent HIG. Realty Partners £22.5m to acquire a site in Whitechapel with a view to converting to lab-enabled space. These micro locations are key to creating successful ecosystems.

Regional revival

The UK is very poly-centric and underpinned by strong universities and teaching hospitals. Many predict a Northern arc of Manchester, Leeds and Newcastle attracting significant investment. Birmingham is another prominent potential, considered one to watch for med-tech, a sub sector of life sciences along with digital health, both booming and growing outside the golden triangle.

In addition, lab facilities record lower occupational density than traditional offices, usually around 19 sq m per employee versus 11 sq m. Therefore, city fringe areas within reach of talent pools will become popular. Growth outside London and the OxCam arc will be slower but there is definitely an opportunity which will be further stimulated by the levelling up agenda.

Housing costs in London and the South East are in many cases prohibitive with supply very low. This is prompting large science parks to build housing on site for staff, but not everyone wants to live next to the office or next door to their colleagues. To attract global talent, getting the residential aspect right is also a must.

The life sciences market in Cambridge is booming but surging house prices could be a headwind

The certainty of income and rental growth forecasts plus the supply demand imbalance has led to significant investment and is resulting in bidding wars on key sites. These are interesting, non-standard assets and the capital chasing opportunities is only going to increase.

Despite the challenges, we are seeing a strong response to the scarcity of space, including office to lab conversions, especially in the golden triangle. Financing undoubtedly requires a specialist lender with market knowledge, able to evaluate key factors to underpin the loan such as site location, likelihood of consent, the track record of the borrower, potential conversion or build difficulties and fallback scenarios.

The key is to deliver the right space in the right location with ample forethought. Success stories will be those that form strong partnerships with expertise for each stage of the process from finance through to development.