

Market Insight

LIFE SCIENCES

EXPLORING LIFE SCIENCES REAL ESTATE

In April 2023 ASK hosted a roundtable discussion forum for key players in life sciences real estate, including developers, funders, valuers and advisers. The group debated current appetite and opportunities in the sector and also its future shape and growth potential. The following is a summary of what was discussed.



RESILIENCE & GROWTH

Has the sector been resilient to the macro-economic headwinds?

All agreed that the last 9-12 months have been unsettled. Nine months' ago there were a lot of big named bidders on projects, all within a very close range of each other. Now the market is seeing fewer bidders across a bigger spread, but is still seeing enough competitive tension for pricing to remain resilient.

Four key reasons were given for the sector's resilience: the supply demand imbalance; experienced and anticipated rental growth; the weight of capital chasing the sector and the continued impact of funding in general (IPOs, grants, VCs etc).

Current supply was said to be very minimal. In Oxford and Cambridge the vacancy rate is comfortably below 1%. Despite the weight of capital chasing the sector there has been a noted outward movement of prime yields to 4.25%

as at April 2023, as reported by Cushman & Wakefield. This is a global figure for the UK's golden triangle based off live bids and assumes a rack rented new build, purpose-built lab building, at a point in time.

Rental growth has also been very steep and has supported the sector. Cushman & Wakefield has reported an 18% growth in Cambridge and 10% in Oxford in 2022. With the lower figure for Oxford due to the lack of stock restricting evidence to prove a potentially greater increase in prime rents.

The sector has started to see some hesitancy from investors. Planning risk appears was often overlooked but now the heat has gone out of the market it is being scrutinised more. In London, projects benefit from a more competitive investment market where real estate values underpinning offices are stronger.

Overall it was felt that the sector has been resilient but not immune to macro-economic effects.

"Prime yields in the golden triangle have moved 25-50bps since September 2022"

SUPPLY

Is the supply issue short-term?

Cushman & Wakefield figures tracking future supply were shared. Almost 1m sq. ft of space is due to be delivered by 2023. 1.3m sq. ft in 2024 and crucially, 4.2m sq. ft across the golden triangle in 2025. All agreed that if this space were available today then it would let immediately but in a few years' time there will be some choice. Many were in doubt as to how much of this space would actually be delivered; to complete by 2026 would require a spade in the ground now and some of these projects are a way off being committed to by the developers.

It was also questioned what the delta would be between new now and new in five years' time. It was expected to be small and far less consequential than it would be in the office market. Function was said to be more important than new in life sciences.



A Cambridge office building acquired for conversion to lab space, funded by ASK

LOCATIONS

Which locations have potential for the sector?

Locations with specialisms and hubs for talent, such as Stevenage in the Cell & Gene Therapy sector, have emerged primarily as a result of GSK anchoring the town, along with the Stevenage Bioscience Catalyst offering incubator and manufacturing accommodation. It was also said to have good local planners as well as backing from the council. Bristol has also seen investment from Mission Street and BentallGreenOak to build upon the emerging R&D and 'deep tech' ecosystem in the south west. Dundee was also mentioned as a city with promise.

All agreed that the war for talent in the life sciences sector is the biggest challenge being faced by companies and means that management is very focused on providing the right accommodation in the right locations to attract and retain the best staff. Working from home is, in general, less prevalent in the sector where R&D and more intensive work can only be carried out in labs.

"The cluster effect is so crucial to success"

Will Canary Wharf be a success?

Most felt the area and current projects would prove to be a great success. The area benefits from having funders right on its doorstep and its close proximity to Whitechapel's hospitals and labs. Everyone agreed that some large pre-lettings for up-scaling would help build momentum as the cluster effect is so crucial to success. It could also act as an overflow for Whitechapel and Paddington which extends its viability. The Elizabeth Line was considered to be a game changer for the area.

OCCUPATIONAL MARKET

What are rental prices at the moment?

Tenant growth was said to be so rapid and space required so urgently, driven by the need to not lose ground to competitors on potential research breakthroughs. Patents also have a lifespan so that fuels urgency too. When these factors are weighed up against rental prices many are willing to pay rents that set new headline levels in a location if the fit out allows them to undertake the research they need to achieve a breakthrough. But, power costs have gone up dramatically too which tenants are factoring in to overall costs.

In terms of current prices, Prologis, who has 100,000 sq. ft of cat A spec. space at £65 per sq. ft, was cited as an example. It was suggested that in some cases landlords were reluctant to sign terms with tenants, holding back because market rent rates are going up so fast.

What are tenants requesting in terms of specification?

All agreed that tenants are demanding very high-specification and appear to be moving to fully-fitted space. Those around the table agreed that this would aid leasing velocity. Some said that there are tenants with very specific demands but in many cases they couldn't afford to be too choosy. One developer said that so much of the capex is spent on the major kit that if tenants want to move benches or partitions it's not a big problem. Their aim is to make sure they can handle 80% of requirements, such as wet and dry space on each floor, air handling of 6 changes an hour, power upgrades and drainage; this is key to limiting voids and reducing capex costs.

"Multi-let buildings allow landlords to take advantage of tenant churn and rising rates"

A healthy lab to office ratio was also advised and the need to keep some shell and core available for specific needs. Small units on a 12-month lease allow for incubator activity. The market was also said to prefer multi-tenants in comparison to individual occupiers as it allows the landlord to take advantage of rising market rents based on tenant churn. Exposure to a greater number of occupiers also allows landlords the ability to circulate tenants around as they mature and require larger space.

Some felt it was sometimes necessary to challenge occupiers on their space requirements, as tenants can end up paying more than is necessary. It was pointed out that there are a lot more buildings available that could accommodate a containment level of 1 (CL1) instead of the higher CL2. However, a funder would always be looking to back a best in class asset.

Availability of sufficient power was said to be a huge issue; labs use around five times more power than an office. Some tenants want supercomputers for crunching data on site.



A mixed-use scheme at King's Cross, funded by ASK, will have 14,000 sqm of lab-enabled office space.

A GLOBAL PERSPECTIVE

How does the UK compare to Europe and the US in terms of the growth of the life sciences market?

It was said that the Swiss have been doing life sciences very well for years. Leiden in the Netherlands was also successful as is Bayer's science park in Berlin. Madrid however was said to be behind the UK, currently trying to form its first cluster. France is also just starting to get going.

The group commented that the UK and the US were the only countries with globally known major universities so it was unsurprising that these markets had quickly become more advanced. As a result of Brexit and the currency, scientists have become cheaper in the UK which is something other countries are keen to take advantage of.

The UK was said to be very much out-raising the rest of Europe in terms of funding but where demand can't be met here we are regularly losing tenants to the US. The sheer size of the US market by comparison to the UK was explained in terms of the 35m sq. ft of lab space in Boston dedicated to life sciences in 2022, with an additional 15m sq. ft under construction. The total life sciences space in the UK's golden triangle, excluding incubators, is over 11m sq. ft. Such burgeoning growth in the sector means that companies will entirely relocate to the US until they can find UK premises.

Is the UK government getting behind the sector?

Many felt that the government has been inconsistent in its attitude and approach to life sciences, highlighted by its u-turn on investment in the OxCam arc, and the omission of the 'arc' in the levelling-up whitepaper. Oxford and Cambridge's poor connectivity was cited as a key issue alongside our onerous planning system which will stymie growth at the rate needed to satisfy demand.

"The UK is appealing to overseas tenants post-Brexit as our currency reduces costs."

Are we seeing a new wave of forward funding for the sector from overseas?

All agreed that institutional and overseas funding has been lacking. There have been some institutional finance examples, but everyone felt that institutions were notoriously risk averse, not helped in this sector by weak covenants but strong rents. It was also noted that at this stage in the development of the market most projects are conversions; they are complicated and hard to get right which brings with it associated risks which institutions are usually unable to accommodate.

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