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Top 10 with…

Breaking new ground

Interview with our experts on life sciences

UBS

Our experts

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> "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."

Life sciences facts:

7

Development sites secured

EUR 3.8bn

Of gross development value (GDV) already secured

240k m^2

Of development space secured

Source: UBS Asset Management, Real Estate & Private Markets (REPM); Data as at June 2024

With a strong long-term growth potential and a distinct social angle, the life sciences sector is developing at a fast pace. Forward-thinking investors are looking for ways to enter this growing niche sector. 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 Gijsbert van Riemsdijk, Ellie Junod, Olafur Margeirsson and Alice Bennett-Morris discuss the sector's dynamics and give an outlook into what the next few years might look like.

1

What are the main macro-drivers behind the life sciences sector's growth in Europe?

Olafur Margeirsson:
The COVID-19 pandemic undoubtedly focused attention on the life sciences sector in Europe and made clear that it is of "geostrategic importance".[1] Besides providing necessities (medicines), the sector accounts for more than 5% of value added in the EU economy and is behind 11% of all exports. Over the last two decades, exports of pharmaceuticals from the EU have grown by 8% p.a.[2] Nearly a million people are directly employed by the sector and it is in the top quantile amongst all industries in terms of long-term employment growth in the EU.[3]

By 2050, 16% of the world's population will be over 65, versus 10% in 2022,[4] 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 can afford increased spending on health.

Underpinning these demographic trends is a sharp increase in R&D (research & development) spending within the industry. This drives employment in R&D, which is accelerating: employment in pharmaceutical R&D in Europe grew by 1.6% p.a. for the first two decades of this century but has accelerated since to 2.2% p.a.[5]

In summary, the sector is of geostrategic importance for Europe, it's long-term growth potential is driven by strong demographics and its growth momentum is positive.

Where do European markets sit compared to other global life sciences markets?

2

Olafur Margeirsson:
The global pharmaceutical industry is the fourth largest market in the world in terms of net sales, with ~15% of sales in Europe, ~65% in the US and the rest of the world accounting for ~20%. The market as a whole is expected to grow by 8% p.a. in the 5-year period ending in 2027 and to continue growing on the back of demographic tailwinds after that. Around 20%, ca. EUR 47 billion in 2022, of global R&D in pharmaceuticals takes place in Europe.[6] Within Europe, Germany and Switzerland contribute ~20% of R&D in the sector with the UK delivering ~15%.

Importantly, it is worth remembering that the European life sciences market, including its R&D activities, is fragmented. One reason is the lack of common regulation, an issue less known in e.g. the US or the UK which applies a single national regulation of the industry. The problem is well known and the European Commission has started a reform of the EU pharmaceutical legislation. For example, one of the aims is to "continue to offer an attractive and innovation-friendly environment for research, development, and production of medicines in Europe."[7]

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

3

Gijsbert van Riemsdijk:
There are several factors which make this niche area worth exploring in today's market. Across Europe, the clear mismatch between supply and demand of space makes investing attractive. 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 previously by Olaf, 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.

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

Olafur Margeirsson:
Europe has not seen the same boom-bust dynamic as the US, where life sciences vacancy rates are around 16.7%, has. The construction pipeline in the US is larger than in Europe despite the high vacancy rates (speaking volumes about the confidence in the long-term growth of demand).[8] European leasing demand was also more resilient but the contraction in venture capital funding hit the sector hard in the US: net absorption turned negative. Consequently, while the US have seen double-digit vacancy rates in multiple markets (nearly 40% in Chicago), European markets have seen nothing like that, seeing vacancy rates usually around 5% or less.[9]

Companies' space requirements are also generally not being met in Europe. As an example, around middle of 2023, at the low point of VC funding in Europe, the active requirements of companies searching for space in the Golden Triangle was around 30% of existing stock.[10] This requirement was not being met due to shortage of space. We therefore conclude that there is plenty of room for the supply side to grow before oversupply becomes a problem especially since the supply pipeline contracted between 2022 and 2023. The vast remainder of the pipeline is delayed due a challenging planning environment, build cost inflation and the price of debt.

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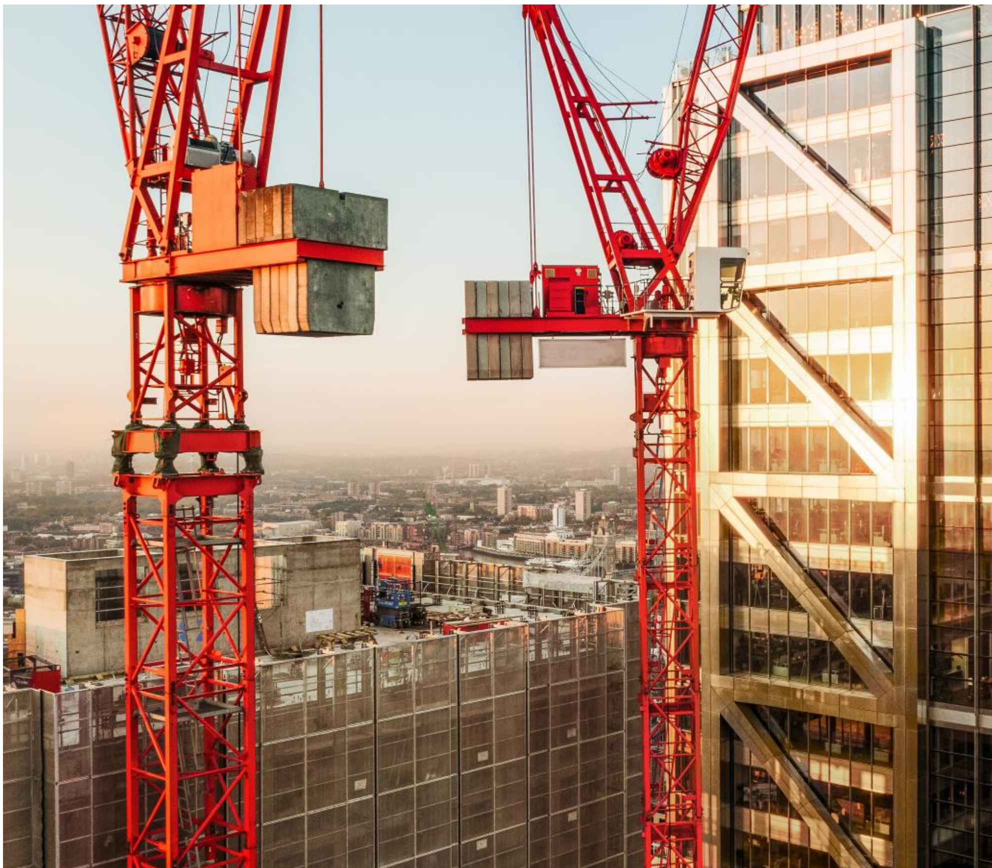


What has happened to VC funding in 2024 and how has it affected tenant demand?

5

Olafur Margeirsson:
Venture capital funding for life sciences in Europe reached approx. EUR 10 billion in 2021, a record year. It dropped to EUR 6.8 billion in 2022 as interest rates hit and startups, and other companies, went through repricing. It marginally grew again YoY in 2023 by 2%. As of middle of October 2024, it stands at EUR 6.3 billion and may reach ca. EUR 7.7 billion by end of the year, a potential expansion of ~10% YoY. Annual growth in VC funding since 2013 is now 15% p.a.[11]

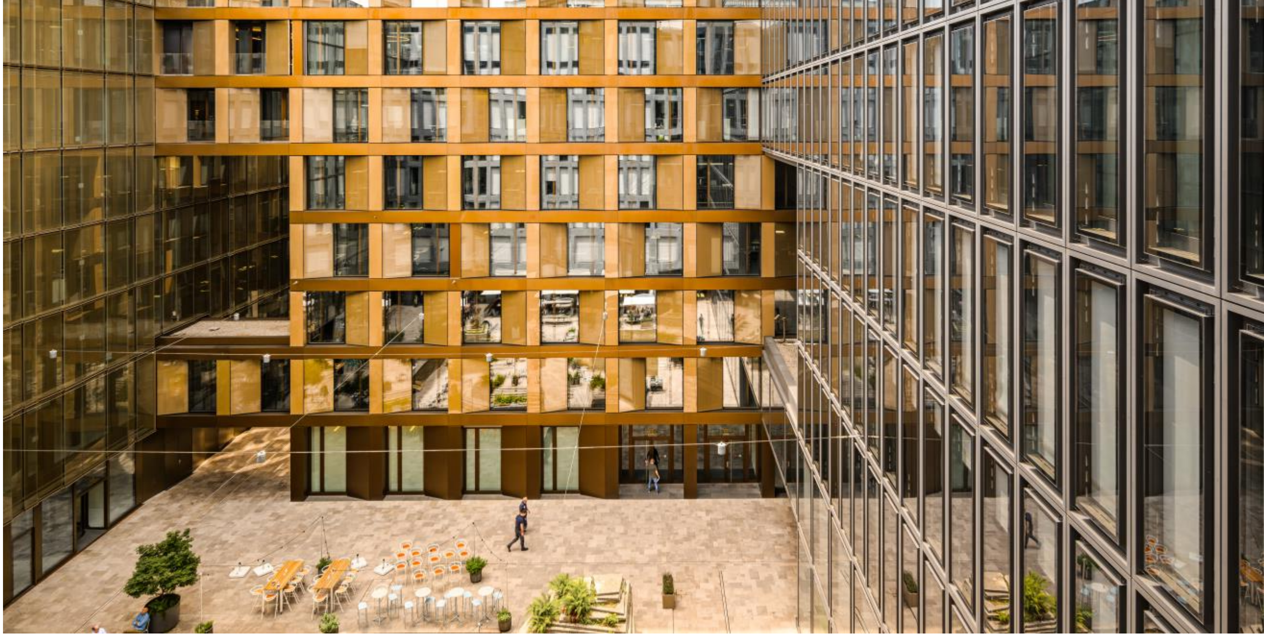
The VC funding cycle is therefore starting to support the leasing market dynamics. We see this in key leasing markets where rents are flat, despite the drop in VC funding, and vacancy rates remain low. We also believe that there is pent-up demand in place from previous funding rounds where companies have not managed to find the appropriate space due to shortage.

Finally, it is important to remember that VC funding is not everything. Public institutions (e.g., hospitals and universities) and large corporations still need life sciences real estate to conduct their research, regardless of what is happening in the VC space. After all, the approx. EUR 47 billion that went into R&D in pharmaceuticals in 2022 was not only financed with VC funding.

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

6

Ellie Junod:
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 across Europe, a development-led approach is the best way to access the market. As there have 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 in the future.



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

Gijsbert van Riemsdijk:
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.

We've made progress to provide a proof of concept, de-risking our UK portfolio from planning risk and delivering our first Good Manufacturing Practice (GMP) facility. Going forwards, our European focused strategy aims to continue the consistency, quality of design and delivery of our successful UK strategy, whilst also partnering with local specialist developers.

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

8

Alice Bennett-Morris:
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. When initially moving into this space, it was really important to UBS 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 and instead using heat pumps, furthermore we would aim to have a significant amount of photovoltaics on the sites. The strategy will target high environmental credentials, such as EPC A or equivalent and BREEAM 'Excellent' as well as developing space that is net-zero enabled. 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. In line with this, the strategy has developed an occupiers framework which will be referenced in all new leases signed across the portfolio. This ensures that ESG factors are considered and implemented during the operation of facilities.

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

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Alice Bennett-Morris:
The life sciences sector exemplifies the mutually beneficial relationship between social responsibility and commercial success. The improvement of society is inherent to the life sciences sector's pursuit of developing treatments that extend and enhance human lives. Thus, real estate has a key role to play to help facilitate the growth and expansion of the sector by providing buildings to allow research, development, and manufacturing to take place that are fit-for-purpose, well located and environmentally friendly. Follow-on social benefits include the potential for facilities constructed to significantly reduce the costs of goods for occupiers, passing on savings to end users and patients, and making new and curative therapies more affordable in the market, supporting their viability.

Furthermore, by creating this space, we are supporting growth in skilled employment opportunities for the local and national economies. 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 looking to quantify the social characteristics and provide that to investors throughout the year, such as the number of skilled jobs created or the percentage of space let to SMEs. Indeed, in line with our commitment to Article 8 of the EU Taxonomy, we have a particular focus on delivering social outcomes.

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

Ellie Junod:
Over the next five years we see the European life sciences real estate market moving closer to the more mature markets 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 Europe 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. Moreover, with increasingly personalized treatments and the growth of Advanced Therapy Medicinal Products such as Cell and Gene Therapy, we expect this to drive further demand for GMP facilities.

10

[1] M. Draghi (2024). The future of European competitiveness. See: *ec1409c1-d4b4-4882-8bdd-3519f86bbb92_en (europa.eu).* Accessed in September 2024.
[2] ibid
[3] ibid and Eurostat data based on the time period 2008-2023. Accessed in September 2024.
[4] *Ageing | United Nations*. Accessed in September 2024.
[5] ibid
[6] *The-pharmaceutical-industry-in-figures-2023.pdf (efpia.eu)*. Accessed in September 2024.
[7] *Reform of the EU pharmaceutical legislation - European Commission (europa.eu).* Accessed in September 2024
[8] CBRE 2Q 2024 US Life Science Market Update. Accessed in October 2024.
[9] 2024 EMEA Life Sciences Industry & Real Estate Perspective. Accessed in September 2024.
[10] *Golden Triangle Lab Space Demand Continues Despite Shortage Of High-Quality Stock | United Kingdom | Cushman & Wakefield (cushmanwakefield.com).* Accessed in September 2024.
[11] Pitchbook, as of 18 October 2024.

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