

## Press Cutting

### Life sciences, the burgeoning asset class ready to emerge in Europe

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## Life sciences, the burgeoning asset class ready to emerge in Europe

As the sizeable transactions carried out in recent months by some of the world's most prominent institutional players indicate, real estate investor interest for the life sciences sector is rising. Established in the United States, well-defined and specialised clusters have emerged in the US as a growing asset class. Still at a very early stage in Europe, it is poised to do the same on our continent.

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Following its October \$14.6bn recapitalisation of BioMed Realty, the largest private owner of life science office buildings in the United States, **Blackstone** announced in December the \$3.45bn acquisition of a 213,000 sqm portfolio from a Brookfield AM. Across the pond, AXA IM Alts made waves in

November with the €500m acquisition of **Kadans Science Partner**, a developer, owner and operator of science parks and lab offices across Europe. But what is this new asset class that encourages such tycoons to take out their chequebooks? "We define life sciences assets as office or industrial buildings occupied for a specific use in the medical, laboratory and scientific research space," explains **Tom Leahy**, Senior Director at **Real Capital Analytics**. "The majority of transactions carried out in the sector concern assets housing pharmaceutical, biotech and medical technology industries."

However, for **John O'Driscoll**, Head of European Transactions at **AXA IM Alts**, the potential scope of the sector is wider: "In the purest sense, life sciences encompass pharmaceutical, biotech and medical facilities, but our definition is much broader and includes agritech, chemistry, food science and mobility." According to Tom Leahy, the sector is "still a relatively small asset class across the globe, accounting for only 2% of all income-producing real estate investments this year". Still, the sector shows an important growth potential, according to **JLL**'s 2020 Life Sciences Real Estate Outlook report, which states that "robust long-term fundamentals within the life sciences industry should continue to draw in venture capital, private equity and corporate investors over the coming years, driving growth and demand for life sciences real estate".

Of course, the Covid-19 pandemic has put the spotlight on medical and pharmaceutical infrastructure, says Audrey Symes, U.S. Healthcare and Life Sciences research director at JLL, in a recent blog: "The production of vital medicines, as well as increased testing and therapies to combat COVID-19, are boosting occupancy levels. Ongoing demand from critical cancer, gene therapy, and immunology research, among other focus areas, continues to provide sustained demand."

Nevertheless, real estate investor appetite for life sciences assets predates the current health crisis, says Mark Burkemper, Senior Managing Director, Harrison Street, whose American life sciences portfolio totals \$2.5bn AUM, including a joint venture with the Massachusetts Institute of Technology: *"Covid-19 might have highlighted the acute need for life sciences sector, but the demand has been in place well before the pandemic started and is spurred on by long-term health and societal challenges."* A sentiment echoed by John O'Driscoll: *"Like a lot of investors, we have been intrigued by this space for a while, as we see the interesting development of the sector in the United States, where collaborations between universities and corporates, as well of their commercialisation, have given rise to an extensive sector."*

## A nascent market in Europe

Globally, RCA data shows that \$10bn of life sciences property had been sold in 2020 through early November. However, the sector is still a nascent niche alternative asset class in Europe, says Tom Leahy, with only €2.8bn invested over the last two years: *"Since 2007, around €3.7bn have been spent on R&D and life sciences facilities in the United Kingdom, followed by Switzerland Sweden and Germany with €2bn each, and France with €1.8bn. The US market is probably 10 times the size at the moment, one reason being that there are very defined substantial real estate clusters around universities, whereas in Europe such assets tend to be specialist and owner-occupied."*

Still, life sciences were deemed the third most promising sector by the Emerging Trends in Real Estate Europe 2021, the annual study conducted by **PwC** and the **Urban Land Institute**, based on personal interviews and surveys with 995 of the most influential leaders in the real estate industry, trailing only data centres and logistics facilities. *"It's been a big trend in the US in the last five years, but I envision there's going to be life science clusters, medical clusters that are going to be developed throughout Europe that will be very in demand from an investor's standpoint,"* one broker told ULI and PwC.

Such is the case for **Harrison Street**, who has recently expanded its third European closed-end fund to include healthcare and life sciences assets. *"We are now seeing a new asset class emerging, following trends set within the US real estate market,"* explains **Paul Bashir**, the firm's Managing Director and CEO for Europe. *"Historically, the sector was dominated by education institutions and corporates, but we are starting to see a lot more real estate led opportunities as the market opens and becomes more fragmented. And as domestic manufacturers are relocating a lot of their overseas production back home, life sciences are becoming one of the key sectors we are focused on in Europe."*

Although American cities like Boston, San Francisco and San Diego have used their head start to establish themselves as the world's biggest life sciences real estate markets, some European countries have the potential to become interesting emerging markets, according to **Frank Roccogrande**, Founding Partner at **Deutsche Finance International**: *"A couple of European markets have the raw ingredients that the key US markets have: universities, private companies, and private research institutions, allowing for cluster networks creation. The most important market in Europe is in the golden triangle between London, Oxford and Cambridge, although even there we don't see a lot of fully life sciences oriented real estate parks at the moment. Once this starts to take off, we should start to see it expand in other countries, cities and sub-markets, with the next prominent markets probably being the Randstad region, in the Netherlands, Paris and Geneva."*

## Attractive fundamentals

The increased interest for real estate institutions for the life sciences sector can be explained in part by a shrinking of their investible universe, according to Tom Leahy: *"Large parts of the retail and hospitality sectors are seen as off market at the moment, while investors are worried by the evolution of office occupancy in the coming years. Life sciences activities are immune from some of the structural shifts affecting those sectors, as they demand the use of specialist equipment inside the facility and are driven by long-term shifts, such as an ageing population."*

These defensive qualities, but also its operational needs, explain in part Harrison Street's appetite for the asset class, says Paul Bashir: *"We like assets that are anti-cyclical, demographically driven strategies and fragmented markets requiring consolidation, as well as asset classes where an operational component gives us a unique access to markets that would ordinarily be difficult to penetrate. Life sciences check all those boxes."* His colleague Mark Burkemper adds: *"Looking at the demand drivers for life sciences, VC funding is at an all-time high, as are NIH and corporate funding, providing excellent tailwinds for our tenants and to sustain the demand level over the next 3 to 5 years. There is still a demand/supply imbalance, both in the US and elsewhere in the world."*

Another advantage for landlords lies in the structure of life sciences leases, which compare favourably to their traditional office counterparts, according to Frank Roccogrande: *"In Boston's lab office sector, for example, leases are structured on a triple net basis, meaning that all the common area costs are pushed down to the tenant. They also tend to be longer than traditional offices because of the heavy technological investments required into the space, 3 or 4 times the level you usually see in offices. However, the space is still easily releasable because very little transformation is needed between life sciences tenants."*

The profile of the latter is also an element in favour of the sector, claims John O'Driscoll: *"The sector benefits from a very invested tenant base, as well as significant covenants anchoring the assets. Because of that, yields are very strong on a risk-adjusted return base."* Nevertheless, this stability does not impose sacrifices in terms of profitability, according to Mark Burkemper: *"Rental growth in the US has been between 5% and 8% over the last 5 years, with 100% rent collections since the beginning of the pandemic whereas other asset classes like retail and offices have struggled."* Moreover, the increased appetite and competition has led to a «significant yield compression in Europe over the past 12 months, in certain markets as much as 200 bps," Paul Bashir adds.

## How to build a European life sciences portfolio

Attracted by compelling fundamentals but faced with a scarcity of existing stock – RCA's database reports around 4,700 life sciences properties worldwide, about 1.5% of the total office and industrial holdings – , investors could find entering the European life sciences sector a significant challenge. A solution can be to buy one of the few existing platforms on the market, as AXA IM Alts managed with the acquisition of Kadans Science Partners. *"The sector is at such an early stage in Europe that even the data isn't very good,"* says John O'Driscoll. *"Acquiring Kadans gives us the opportunity to be a first mover in Europe, by marrying a strong real estate investment platform with a strong operational business."*

However, such shortcut opportunities are rare. Furthermore, a European portfolio-building strategy based on the acquisition of existing assets will quickly be confronted to the lack of liquidity observed in the emerging asset class, as well as a greater need for expertise than in other sectors. *"Life sciences assets are not traded that often in Europe and requires a specialist asset management,"* says Tom Leahy. *"You have to either buy a platform or build it from the ground-up. To that end, providing capital to the owners of existing assets and funding expansion but retaining their management expertise is a good way to gain scale."*

Another route to the life sciences market goes through development. In the U.S. alone, \$9bn of life sciences property is currently under construction, RCA data shows. *"If you want a private equity type investment, there are very little opportunities because most of the owners have no intentions of selling,"* Frank Roccogrande explains. *"In Europe, this lack of product leads to very high price premiums, which is why we only invest in ground-up development operations with a develop-to-core approach."* But this avenue is not without challenges for investors either, says Mark Burkemper: *"There is a complexity to life sciences assets and developing is not something that you can do overnight, which it makes it more difficult for investors to enter the market. For example, compared to general office assets, life sciences are more specialised with higher load factors, enhanced building systems and greater energy capacities."*

Moreover, the challenge for investors and developers will be to assemble the right rental mix allowing the emergence of an attractive ecosystem, a sine qua none condition for the establishment of a life sciences real estate market. In the end, more than any other sector, the success of life sciences assets hinges on the strength of the ecosystem in which it is operating. *"Scientists and leading biotech companies want to be surrounded by other institutions that can help idea generation and breakthroughs,"* reminds Frank Roccogrande. *"It is not just about having a shiny building, but about creating an environment where all the needed elements can intersect."* Nevertheless, given the strong demand and significant growth potential of the sector in Europe, he remains confident that the young asset class will emerge on the continent over the next decade: *"In Europe, the sector will rise in importance over the next cycle coming out of Covid-19. It takes years for these clusters to grow, but even though this evolution could take from 5 to 10 years, once it starts it will expand rapidly."*