

# getting your PROPERTY STRATEGY right

The global biotech industry is, according to a recent report by Ernst & Young, 'turning up' despite a relatively subdued recent climate. Recovery in the biotech sector during 2003 was almost six months ahead of predictions and overall growth continues apace. In the US, which is still the powerhouse of the sector, the industry's market capitalisation is up 40% on its level at the end of 2002. By 2005, biotech-derived products are predicted to account for €144 billion of worldwide output, a 43% increase on its current level.

**By Martin Sylvester**

The European market has developed rapidly since the mid-1990s and three countries – Germany, the UK and France – have led the way. However, the basic ingredients for developing a successful biotech industry have been established all over Europe and several smaller countries are hot on their heels including, notably, the Medicon Valley area between Sweden and Denmark. The attrition rate of small company failures remains high and very few European biotechnology companies have yet reached an optimal size, and even fewer have earned significant profits.

There are now very clear signs that over the next few years the biotech industry in Europe will continue to mature and we are currently seeing a rash of mergers among companies of the same nationality, plus cross-border mergers and acquisitions – recent examples being Belgium's UCB acquiring UK-based Celltech. It is, however, likely to be many years before European biotechnology companies reach the orders of magnitude of their US competitors and allow them to compete in the M&A market.

The pharmaceutical industry collectively is undergoing a period of sustained consolidation and change. Some of the key drivers are as follows:

- M&A activity within big pharma and biotech sectors.
- Patent expiries and generic drugs.
- Separation of R&D, Sales and Manufacturing.
- Growth of outsourcing/offshoring.
- Government intervention in drug pricing.
- Availability of funding for start-ups.

In the UK and elsewhere, public opinion on GMOs (Genetically Modified Organisms) and animal testing in particular, continue to loom over the industry. A recent survey by the European Commission, however, finds that "support for medical applications of modern biotechnology in the areas of pharmaceuticals and genetic testing remains high and does not appear to have been affected by the controversies over GM crops and foods."

## Relevance to the property market

Since the decline in the IT market, inward investment agencies and local and central government have, in many countries, turned their attention to life sciences R&D. The ability of these companies to create high quality employment, encourage technology transfer and attract support industries makes them highly attractive, not least to development agencies in the UK.



Medivir building nearing completion



Proposed new development at Chesterford Research Park

As part of this strategy, there has been a plethora of science parks planned up and down Britain, many of which will take many years to come to fruition, if at all. The most successful locations for science parks in the UK, however, are still focused around well-established science clusters such as that found in Cambridge, Oxford and in and around London.

What is it that makes a good biotech location and what should companies look for when choosing their headquarters?



Central facilities building under construction

### Where does demand for R&D property come from?

- **Institutions** (eg Wellcome Trust, Imperial Cancer Research, Government Agencies such as DSTL, Met Office)

Usually require large self-contained campus sites and pre-lease or build own buildings.

- **Large biotechnology companies** (eg Biogen, Serono, Amgen)

Small, although active, sector in many European countries. In the US, these companies often require over 1 million sq ft of space across the country, usually focused on two or three locations. Often pre-lease buildings over 500,000sq ft and will invest heavily in fit out and commit to longer lease terms.

- **Pharmaceutical companies**

Have similar requirement to institutions but are often less concerned with sharing sites with other occupiers. Larger companies may pre-lease or buy land to build and many may not need to be in close proximity to universities and other institutions. They are more concerned with access to labour and the vibrant commercial activity associated with being based on a science park.

- **Large corporates with an R&D need**

Many large multinationals will base their R&D functions close to a good supply of graduates and universities. This is a very diverse sector in property terms.

- **Emerging science sectors** (eg genomics, bioinformatics, nanotechnology and proteomics)

Some of these companies are now substantial entities with large property requirements and many are located within science clusters.

- **Information technology design**

Significant occupier of space in science parks. Tend not to favour collaboration/interaction to the same extent and are typically more self-contained than companies in the life science sector.

- **Start-ups**

These companies are often created directly from universities or other primary research and need generic laboratory space in incubator buildings with high levels of service provided on site. They will often need to be near to the 'mother' organisation.

- **Outsourcing companies**

Typically have substantial, systemised laboratories.

- **Universities**

Universities are often now becoming more commercial and are locating functions within a commercial environment away from the main campus.

Source: CB Richard Ellis endorsed by Carter Jonas, joint agents on Chesterford Research Park

We have certainly found it to be the case that a strong science base is the most critical factor. Evidence of strength in this area should be drawn initially from the quality and quantity of primary research entities such as universities, teaching hospitals and research institutes. The most successful clusters also have a substantial presence of large corporate R&D – this proves to inward investors that the location is commercially viable.

It is important that young, growing biotech companies understand the importance of location, their

property needs, how they will change over the short and long term and what options are available to them.

Similarly, however, it is crucially important that the property market keeps pace with changes in the biotech industry and that its developers and advisors are able to provide exactly the right space, support and advice at all stages of a company's development.

The growth of the global biotech market is having a major impact on the property sector. Developers and investors are seeking to respond to the specific needs of the biotech industry, following a trend set by developers in the mature science clusters in the USA, such as Boston/Cambridge, South San Francisco and San Diego. These areas have reached sufficient maturity to support a number of specialist developers who provide laboratory space at commercially viable rents.

The relationship between the property and biotech sectors in Europe particularly is still evolving. The property sector in the UK has in the past, for example, been typically based on long leases with landlords keen to secure large tenants with a proven financial track record and more flexible accommodation which can be adapted for a wide range of occupants.

Biotech companies, on the other hand, have often required small units of highly specialised space for a short time period and with no proven track record and funding complications.

As developers, investors and their advisors have adapted to this new market, the opportunity for biotech companies to find suitable accommodation has increased. So what are the options and what issues should be considered?

### Accommodation options

Biotech companies need to consider the options for acquiring space very carefully as property could be their single largest outgoing. They should also allow for the fact that rentals are often higher than market averages for scientific laboratories because the developer has to pass on the cost for building the specialist facility.

Bespoke pre-lets, other than for large facilities, generally are not appropriate because for a developer to build a bespoke laboratory, it would need a good covenant and at least a 15-year lease agreement, something that most biotech companies are unable to commit to.

It may be better in some instances therefore to look at:

- Acquiring or occupying space which is surplus to another tenant's requirements and adapting it.
- Sub-letting space in another occupier's building.

Recent and ongoing consolidation of the pharmaceutical and biotechnology companies may lead to an increase in supply of high specification laboratory buildings that become surplus to requirements over the next few years. This may create opportunities for some smaller businesses in need of laboratory space. Likewise if companies separate or outsource functions such as clinical trials and manufacturing, this could free up space on older, self-contained sites.

If the recovery of the funding market in the US flows through to the rest of Europe, we may also see companies securing sufficient funding to grow beyond incubation space to their own buildings. This frees up smaller units and provides both challenges and opportunities to the biotech company and its developer landlord, to find the right accommodation in the same or similar location.

A real benefit, in property terms, of clustering is that a wide variety of options could be available to any one biotech company. From newly completed, speculative space to sub-lets to bespoke accommodation. In all instances, speaking to property advisors and developers with specific requirements will most likely open many options and avenues to explore.

Biotech property is neither solely offices nor R&D space and its provision continues to challenge the property community. However there are now a number of very specialised and knowledgeable advisors and developers who are able to work with biotech companies to find the exact solution to their needs.

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## Case study: UK biotech market

The UK biotech market is currently valued at £8.7 billion, making it the largest in Europe. It is home to around 500 dedicated biotech companies and has been identified by the Government as a target for further growth. Europe's early activity in biotechnology centred predominantly on the UK. Academic life scientists here revealed an entrepreneurial spirit similar to the US and venture capitalists provided the funds to support this enthusiasm.

Part of the challenge for UK property developers, as elsewhere in the world, is in the very nature of the biotech market itself. Companies are often young, pre-revenue and can be dependent on a single big idea. There is a high attrition rate within the sector and often a funding 'crunch' which determines whether companies succeed or fail.

The development process takes at least seven years and companies can struggle for funding at each stage. Add to this the possibility of products being sold off, activities outsourced, mergers, acquisitions and joint ventures which could alter property requirements at any stage. Companies need both office and laboratory space and may have very specific requirements involving expensive fit outs.

In short, the average biotech company has little money, no capital strength and needs short term, specialised space that is costly to build.

From the biotech company's standpoint, these innovators generally do not want long-term liabilities and are driven very much by the need to be near:

- 'Mother companies'.
- Other academics and research.
- A skills and knowledge pool.
- Investors, venture capitalists, possible joint venture partners and support services.

The presence of a large pharmaceutical company, for example, can play an important role in engendering confidence in businesses at an embryonic stage. As a result, biotech companies like locating near to one another and the UK has very established biotech clusters which can often be found around universities or centres of excellence, such as has been the case in Cambridge and its surrounding area.

The clustering of biotech companies is further strengthened by the fact that many businesses like the collegiate feel of dedicated science parks and benefit from the amenities on site. Twenty per cent of science park occupants in the UK are in fact biotech-related companies.

Biotech companies also often prefer to be in a business environment run by developers which understand their needs, rather than occupying space run by academic institutions.

Despite the past difficulties between marrying the needs of the biotech and property sectors, some science parks have been extremely successful. Some of the most successful in fact are those which, while not necessarily offering incubator buildings as such, do provide what the tenants need in terms of relatively cheap and flexible accommodation.

According to CB Richard Ellis, the 10 key factors for biotech companies in selecting a suitable location are as follows:

- 1 Strong science base – established presence of academic, institutional, health or corporate R&D.
- 2 Skilled workforce – presence of sufficient quantities of workers with the right skills (need to include support staff as well as key researchers and also allow for the implications of planned growth).
- 3 Effective R&D networks – presence of similar companies, organised industry groups, active collaboration, academic links etc.
- 4 Policy environment – presence of supporting planning, regulatory and legal frameworks.
- 5 Entrepreneurial culture – presence of industry leaders, companies facing similar challenges, serial entrepreneurs.
- 6 Growing sector base – presence of full spectrum of industry from large pharmaceuticals to spin-outs including SMEs.
- 7 Ability to attract key researchers – presence of quality environment, housing, education and other amenities.
- 8 Property and other amenities – presence of full spectrum of space, including for specialist uses, landlords who understand sector tenants' unique needs, space to grow, scientific amenities.
- 9 Finance – presence of full range of finance options including business angels, venture capitalists, specialist banking groups and opportunities to create strategic alliances.
- 10 Support infrastructure – presence of lab tech companies, IP lawyers and other specialist support groups.