

Rising Availability Hits Biotech Labs

Wave of New Lab-Oriented Office Space Threatens To Overwhelm Stagnating Demand

By Phil Mobley

While explosive growth in life sciences in the past decade has stoked demand for lab space, making it a hot commercial real estate niche for investors, demand for lab space in office buildings has softened. That comes just as construction is completed on millions of new square feet of property.

The type of lab space required for life sciences research is not easy to define in generic terms. Much of it is built to stringent requirements based on the organization's particular needs. Broadly speaking, much of the early-stage research into the efficacy of new, high-tech applications in medicine, agriculture and other biological sciences takes place within facilities of major medical and educational institutions, often with the aid of government funding. From there, a promising concept may attract outside investment, at which point the researchers begin to scale efforts in their own space.

This space is often housed within a building that looks like a traditional office building, located in proximity to the institutions from which the new entity sprang. It is common that 50% to 70% is devoted to highly specialized scientific research, with the remaining 30% to 50% serving as administrative office space. These highly customized build-outs are a double-edged sword, making tenants sticky but also sometimes presenting difficulties for repurposing the space for other users, even those also in the life sciences sector.

As research and testing progress, the needs of the organization can change. They may soon require more storage space for chemicals, tissue samples and other special materials. They may also need facilities in which to begin manufacturing and distribution, a function often outsourced to contract research and manufacturing organizations. These buildings can look less like office buildings and more like small-scale industrial or flex buildings, and it is not always as crucial that they be located as close to the core of the research ecosystem.

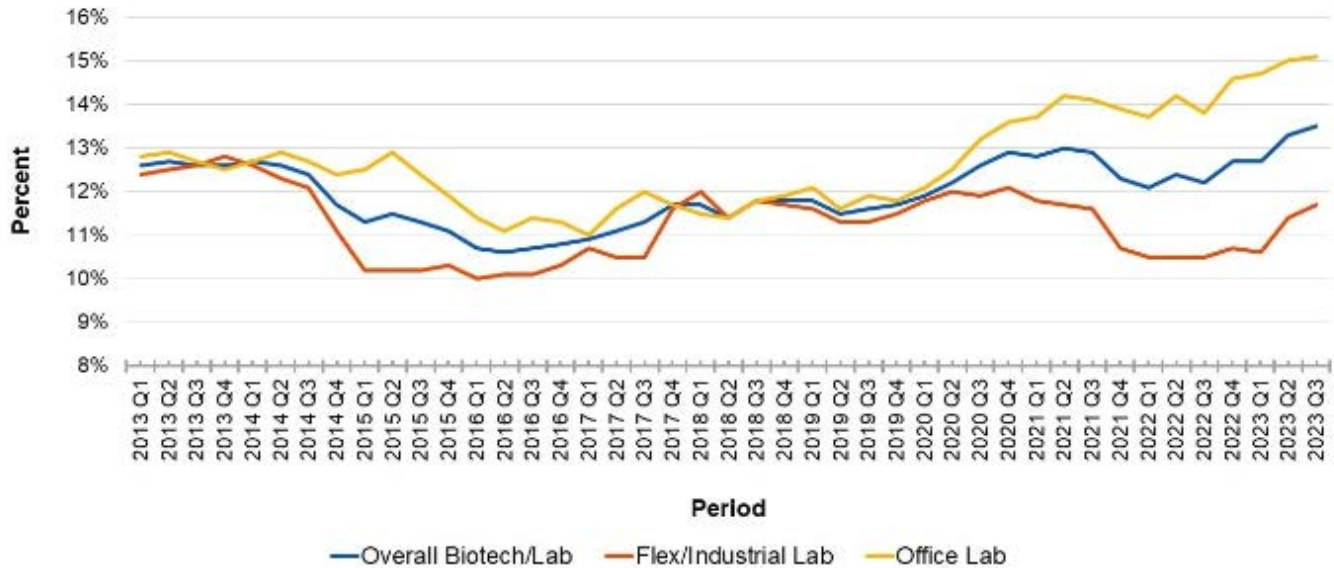
It should be noted that, though the scenario described above is representative, there is a great deal of variability in how life sciences research is carried out and in what types of facilities. Still, the relative performance of different types of biotech-oriented real estate reveals some interesting contrasts.

Following the overall trend in the office sector, vacancies in lab-oriented office buildings began rising in 2020 with the onset of the pandemic. By early 2021, vacancy had leveled off only to surge again beginning in late 2022 as rising interest rates squelched venture capital investment and throttled demand for new specialty lab space.

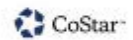
But while demand has stagnated, supply has been the larger culprit behind the rising vacancy:

Lab Vacancy Is Rising More in Office Buildings Than in Flex/Industrial Buildings

Biotech/Lab Vacancy Trend by Subtype
Properties Three-Star and Above and 25,000 Square Feet or Larger



Source: CoStar, August 2023



Over 7 million square feet of new biotech office space was completed in 2022, nearly twice as much as the annual average over the previous decade. Another nearly 3 million has come on line so far this year.

This supply wave is the result of developers scrambling to meet the needs of an industry in which employment has grown at three times the rate of overall job growth since 2013, and it has been exacerbated by the fact that the depression in demand for traditional office led many owners to pivot their existing buildings toward labs.

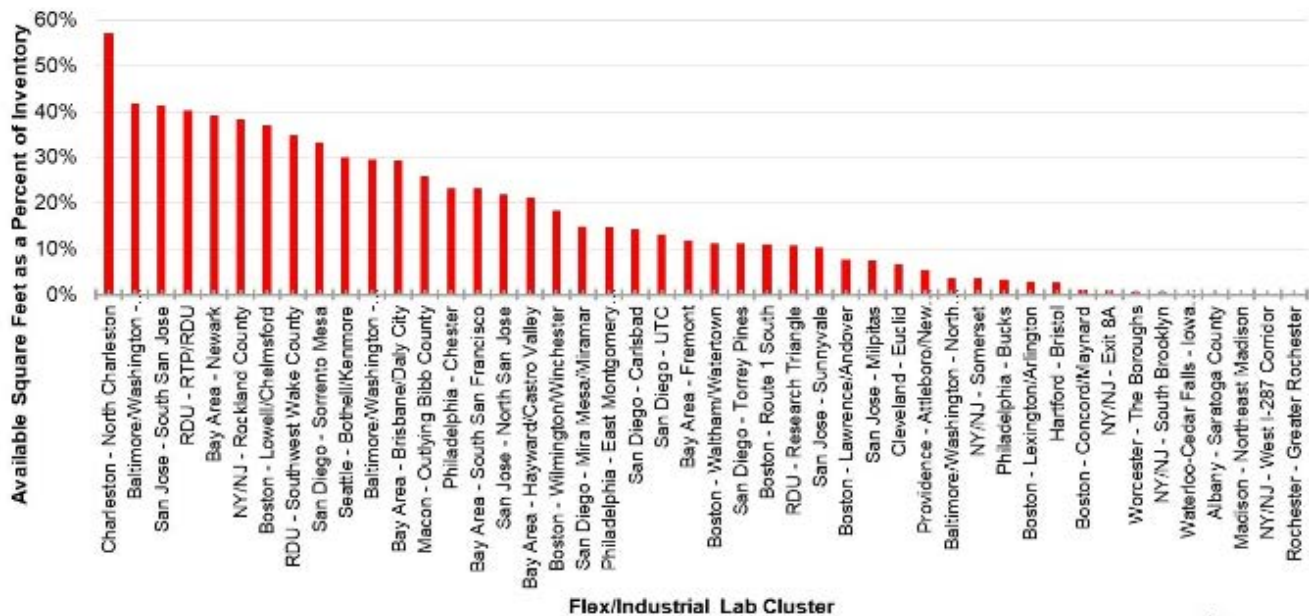
On the industrial/flex side, the story has been more nuanced. The pace of demand growth has slackened, but construction has been more modest. It is easier and cheaper to repurpose lab-oriented industrial and flex space for other uses — such as other forms of manufacturing, distribution and research — than it is to do so with custom-built lab offices. Thus, while vacancy in industrial/flex labs has risen recently, it is not outside its historical range from the past 10 years.

The effects of this shifting market are being felt differently across major biotech research clusters in the United States. In the Boston area, for example, three-quarters of lab space in the market is in office buildings. This is in part because of the market dynamics in the research and venture capital ecosystem surrounding the hospital systems and universities in Cambridge, Longwood and other area clusters.

By contrast, almost two-thirds of the lab space in Raleigh-Durham, North Carolina, and San Jose, California, is in industrial or flex buildings, a function of both the availability of land and the types of research centered in these markets.

Just Under One-Third of Major Flex/Industrial Lab Clusters Currently Have an Availability Rate Above 20%

Availability Rate in Flex/Industrial Lab Clusters With More Than One Million Square Feet



Source: CoStar, August 2023



The impact is clear at the level of specific geographic clusters. About one-third of the largest industrial/flex lab clusters now have an availability rate exceeding 20%, most outside major urban areas. A higher percentage of the largest office lab clusters meet or exceed the 20% availability threshold, including some in the central parts of Boston, San Diego and San Francisco.

There is reason to believe that the current challenges in biotech-oriented real estate will be relatively short-lived. The long-term drivers of government funding, an aging population and technological advances with the potential to improve quality of life are significant tailwinds. In the near term, however, there appear to be struggles ahead for several oversupplied lab clusters, especially those where the industry tends to occupy more space in office buildings.