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Biotech Real Estate Explained

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The biotech and biofuels industry are critical employers in San Diego and contribute to high paying jobs in the region. The industry goes back decades to the non-profit Torrey Pines research institutes such as The Scripps Research Institute, The Salk Institute, Sanford Burnham and UCSD. These research organizations are responsible for spinning out many companies, and are the heartbeat of new start-ups in San Diego. Today, these companies are spread over Torrey Pines, UTC and Sorrento Mesa, and some have migrated to Del Mar Heights and Carlsbad.

Biotech companies have a very different use for their facilities than that of an office tenant. The nature of how the buildings are built and organized is completely different than office buildings, including the kinds of water systems, heating ventilation and air conditioning, electrical systems, fire control, and interior structural clear heights. Biotech companies have fume hoods, cold rooms, clean rooms, tissue culture rooms, and other unique infrastructure. This infrastructure is expensive to install and the typical tenant improvement investment in these facilities ranges from two to four times the cost to build out traditional office space. For example, office space costs $40 to $60 per square foot to improve, whereas costs for biotech companies range from $100 to $175 per square foot to improve.

Biotech companies also have unique risks when it comes to their facilities that must be considered when leasing space. These risks include the complexity of planning horizons, capital expenditures required (improving the space) and the lack of flexibly found in a biotech real estate lease.

Planning

One challenge with biotech companies relates to the long lead times in bringing a new drug or product to market combined with matching a space planning process. Often times, companies build out an entire facility, hoping for FDA approval with millions of dollars at risk. What's the best way to target the initial space, given that the science is uncertain? How do you ramp up space when milestones are met, or ramp down when milestones are not met...or eliminate the facility entirely if it is no longer needed? This can be accomplished by negotiating expansion or contraction rights into the lease, anticipating which departments may be moved offsite should expansion or contraction be required.

Capital

When leasing space, biotech companies must ensure that their tenant improvements are kept to a minimum. Higher improvement allowances translate into higher rents, and often companies sign longer-term leases as a result. One way to minimize costs is locating a facility with infrastructure that can be re-utilized, thus eliminating the need to start from scratch. A facility requiring fewer improvements will also reduce the security deposit required by the landlord. Since most biotech companies are pre-revenue, it's common for a landlord to require above a one-month security deposit, and deposits in excess of one year's rent are not uncommon in many cases. A lower capital investment a landlord needs to infuse into the space to accommodate the tenant's needs, the less deposit, and the less rental rate and a shorter lease term required. Last, when negotiating your renewal option, ensure to negotiate the renewal price doesn't take into account improvements paid for by the tenant, or you will be charged a higher future rent for your own investment into the space.

Flexibility

A biotech company's dream is to lease space when needed, on a year-to-year basis, while the landlord holds the balance of the building off the market for future expansion. That dream is not a viable reality. Given the large amount of capital that building owners have to invest for a biotech company, common lease terms range from 7-10 years...longer than any other industry. So how can a company structure a favorable lease, but limit the risks at the same time? There are several ways to balance this time, cost and risk. First, locate into building that is owned by a landlord who also owns several other properties in the area, making it easier to relocate into another building in the landlord's portfolio. Second, acquire space in a business park where there are multiple tenants who have leases expiring over time. This increases the odds that growth space will be available nearby when required. Third, obtain a termination right in your lease should the landlord not be able to accommodate expansion needs. Last, select a shorter term lease of three to five years, whereby the business reuses existing tenant improvements built by a prior company. While the space plan won't be perfect, compromising over the ideal layout of the space may be the best way to mitigate the risk of having to sign a long-term lease.

Biotech companies are in the business of saving lives, but also in the business of making money. Real estate for biotech companies can be one of the most expensive and inflexible ventures for these companies, and if not done right, can place the entire company at risk. While it's impossible to forecast the future, taking the precautionary measures outlined above will enable a biotech company a greater chance of survival by properly planning the space, minimizing capital expenditures and obtaining flexibility that is required.

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