

The Wet Lab Space Mixup

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“Wet lab” space is used by the biotech industry for vital research and discovery purposes (picture your high school chemistry lab on steroids). Most of the region’s wet lab facilities are clustered in Torrey Pines, spreading out to Sorrento Mesa, Sorrento Valley and UTC, with a smaller amount in Carlsbad to support the handful of biotech companies in North County.

A recent Union-Tribune article quoted me as stating that the availability of wet lab space in Torrey Pines was 22 percent, while the landlord brokerage firm of Cushman & Wakefield reported it as only 10.1 percent in the same article. So who is right? How could we be so far apart, particularly when we both generally agreed on the total amount of available space in that market?

If you have ever read “How to Lie with Statistics” you know that the difference is in the denominator. Making the total size of the market, aka the denominator, as large as possible reduces the apparent availability rate, and by extension, the market appears much stronger than it is.

For example, if we want to know the vacancy rate in the local apartment market, we certainly would not include owner-user single-family homes in the denominator. Similarly, nor should the leasing market for lab buildings in Torrey Pines include the square footage owned and occupied by the likes of The Scripps Research Institute, The Sanford Burnham Medical Research Institute, Johnson & Johnson, Pfizer and UCSD. A full-service brokerage firm is the property owner’s outsourced sales and marketing department, and promoting understated availability percentages helps to keep rents high, and gives landlords a psychological edge at the negotiations table.

The newest tactic in Torrey Pines is to list available space for lease as “negotiable” rather than posting asking lease rates. If landlords don’t publish asking rents, then tenants can’t have expectations about market pricing, and tenants have to trust the brokerage community to accurately report leasing information.

Lab space ownership in Torrey Pines is concentrated among three large, well capitalized, landlords: Alexandria Real Estate, BioMed Realty Trust and HCP. Like the concentration of owners, there is a concentration of the landlords’ listing brokers in Torrey Pines: Jones Lang LaSalle represents 31 percent of the square footage listings on available space; Cassidy Turley represents 46 percent; and Cushman & Wakefield represents 13 percent. It’s reasonable to think that with a concentration of owners and listing brokers, that it might not be a fair fight for tenants trying to get the best package of lease concessions. Ask the landlord listing brokerage community, and they will promote that the market is active and that rents are \$2.50-\$3.25 NNN (base rent).

The reality for Torrey Pines wet lab space is that availability rates are 34 percent (including two buildings Pfizer has for sale totaling 195,000 square feet that will inevitably fall into the available leasing pool) when the owner-user real estate and office buildings are removed from the market data. The average time on the market for wet lab space is approximately two years, and the market hasn’t been healthy for over five years. I completed a Torrey Pines lease in March for a 50,000-square-foot wet lab tenant at a \$1.73 effective NNN rent over a five year term — well below what the landlords’ agents are promoting the market to be. The Hughes Marino team did another Torrey Pines lease a for 23,000-square-foot tenant where the tenant improvement allowance provided by the landlord to remodel the space was greater than the total rent consideration — simply unheard of in recorded history. If a company will move off the Torrey Pines Mesa to Sorrento Valley and Sorrento Mesa, second-generation lab space is less than \$1.70 NNN (base rent).

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Prices are depressed because supply is high and demand is low — Economics 101. Most new biotech companies created in the last 10 years don't need wet lab facilities. Venture capitalists now fund biotechs at a later stage of maturity, whereby the biotechs don't do basic research and discovery work, and therefore don't need wet lab space. Those that do discovery are often outsourcing the research functions that would have required wet lab space. Wet lab space needs have been further reduced by employment reductions at Merck, Pfizer and other big biotechs and the consolidation of the biotech industry through mergers and acquisitions. This is the new normal, and it isn't good news if you own wet lab buildings in San Diego.

The good news for biotech companies that do require lab space is that there is ample quality space at rents that are lower than they have been in 15 years. All of this will help our San Diego biotech companies keep their costs down as they seek to advance their important scientific research efforts.

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