U.S. Life Sciences Property Report

5 lab trends showing opportunity ahead

JLL SEE A BRIGHTER WAY

Research

United States

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Key findings

1 Lease terms are shrinking in an occupier-favorable market

2 Asset and neighborhood quality in Boston, the Bay Area and San Diego are driving leasing activity in a down market

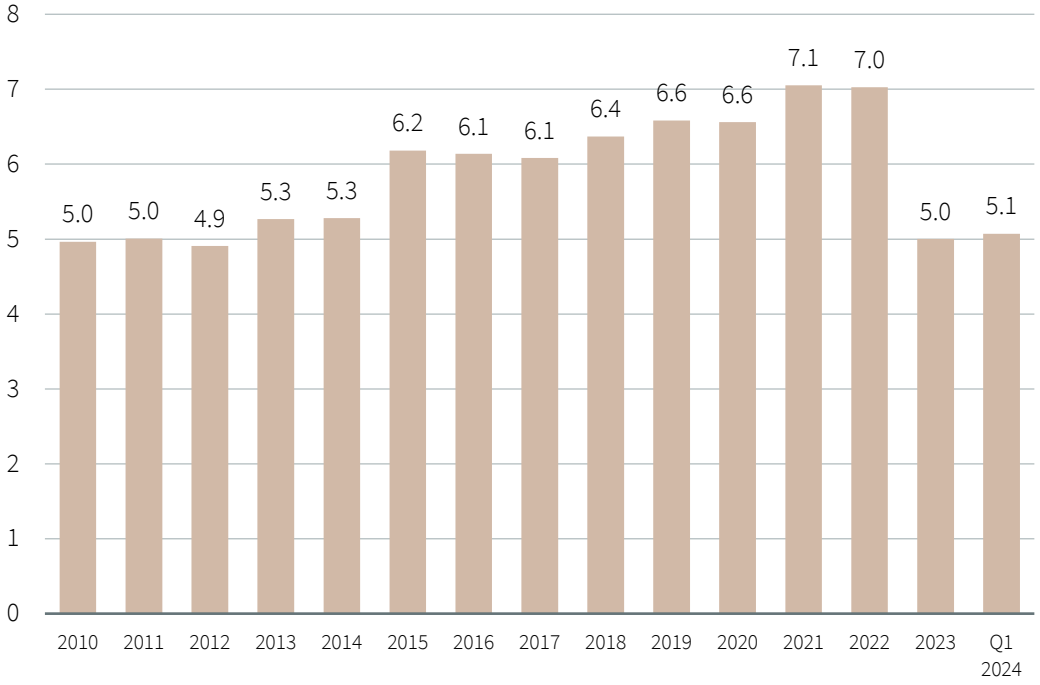
3 Demand grows across the U.S., particularly in the Bay Area

4 The supply-to-demand ratio is mediating but still has a long road to normalization

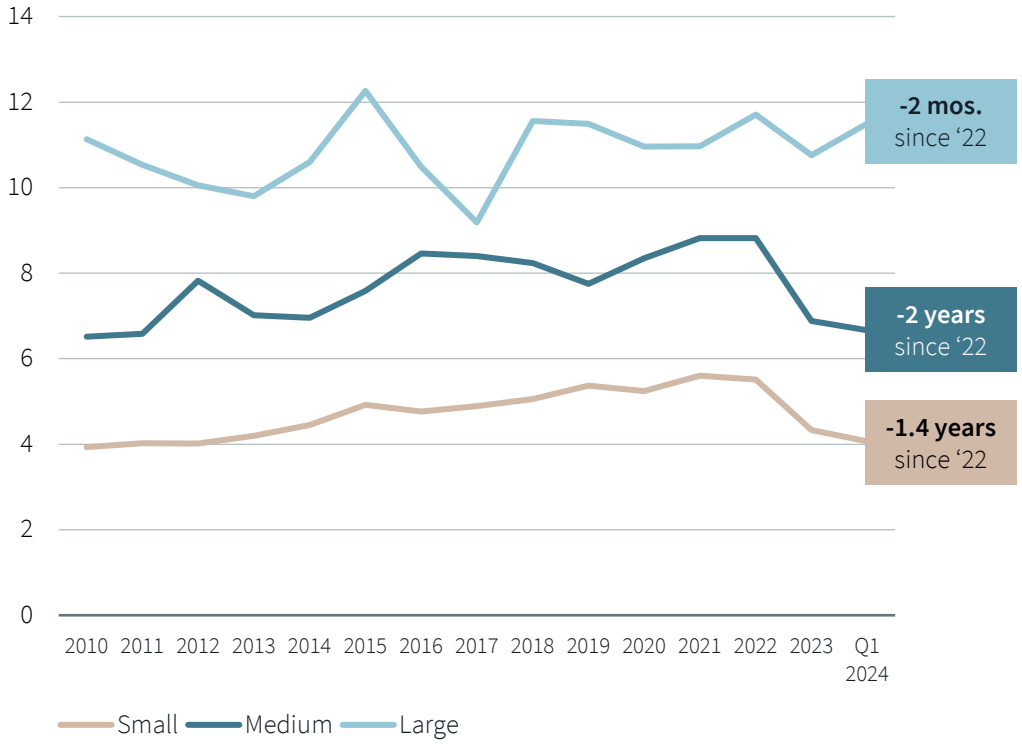
5 Newly added vacancies set to fall precipitously after 2024

1 Lease terms are shrinking in an occupier-favorable market

U.S. average lease term (years)



U.S. lease term by deal size (years)

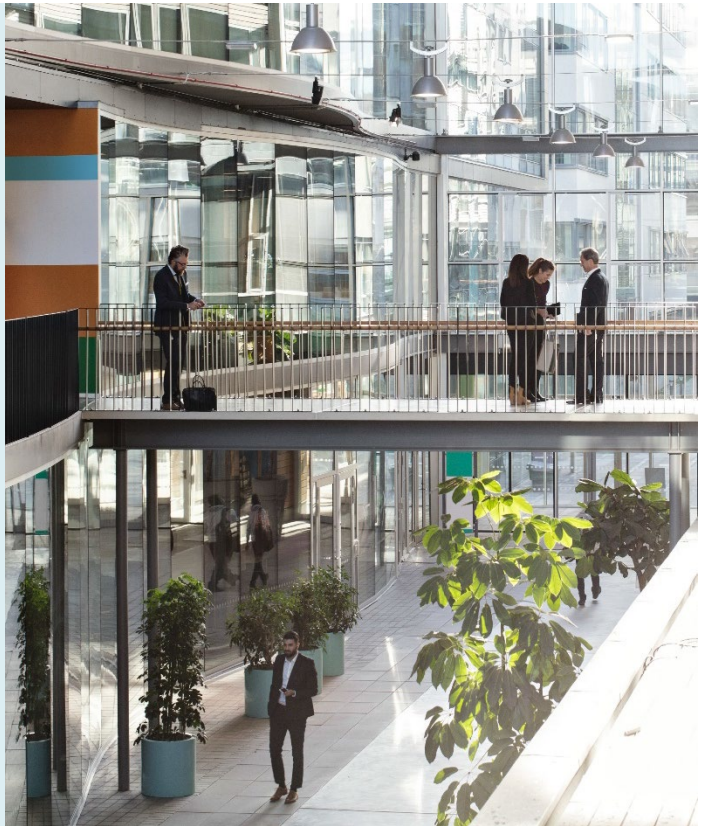


Source: JLL Research; Greater DC, Boston, Denver, Philadelphia, New Jersey, Bay Area, Raleigh-Durham, San Diego, Seattle

1 Lease terms are shrinking in an occupier-favorable market

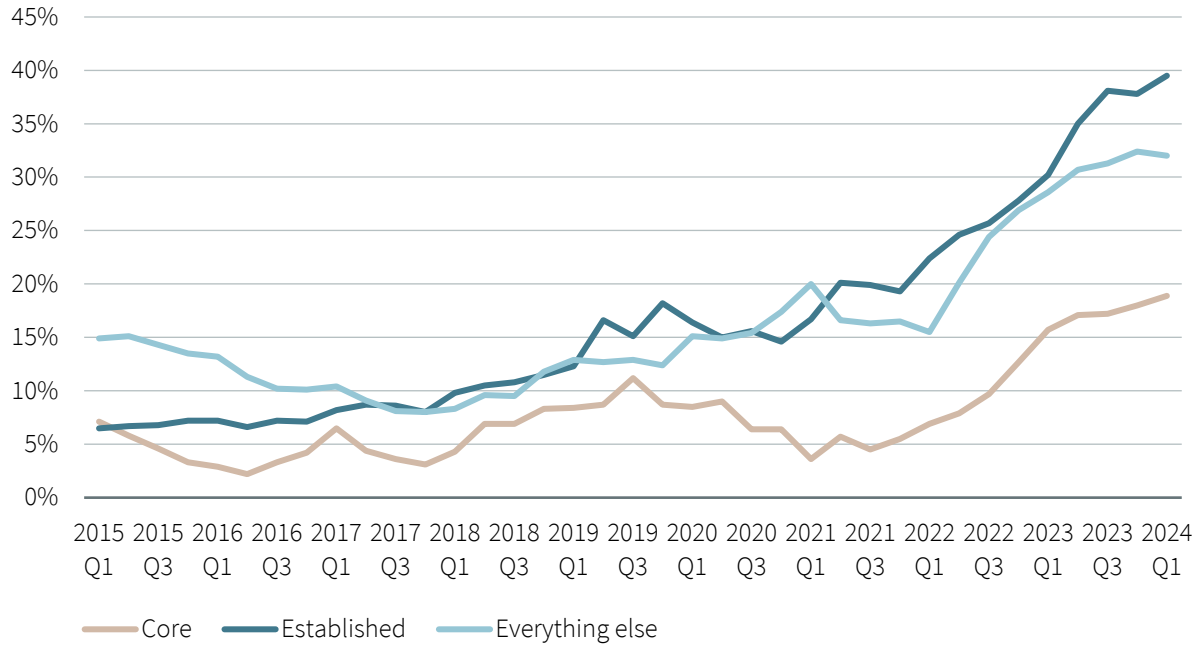
The average lease term of deals signed across the U.S. has shortened over time. Today, it is back in line with the early 2010s, when the average term was around five years. In the second half of the last decade, demand started to outpace supply, giving landlords greater leverage to negotiate longer lease terms, even when it didn't necessarily align with the funding and growth trajectory of start-ups. More recently, however, supply has outpaced demand across markets, **putting leverage back in tenants' hands and allowing start-ups to push for shorter terms.**

This is particularly evident in smaller and midsize deals, which make up the majority of leases being signed today. Compared to two years ago, the average term for middle-market deals has decreased by two years, while smaller deals have decreased by almost a year and a half, aligning to the market conditions of 10 years ago. Though there are few larger deals being done today, their terms have been more consistent in length. Most of these companies are established and stable, permitting them to make extended decisions about their space needs in comparison to smaller companies in the start-up phase.

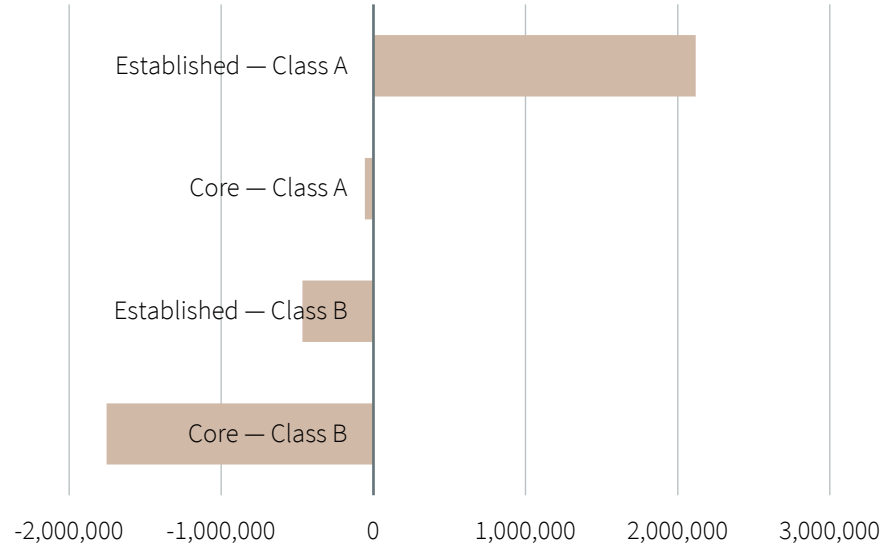


2 Asset and neighborhood quality in Boston, the Bay Area and San Diego are driving leasing activity in a down market

Total availability rate



Total absorption s.f., since Jan. 2023



Source: JLL Research; Boston, Bay Area, San Diego

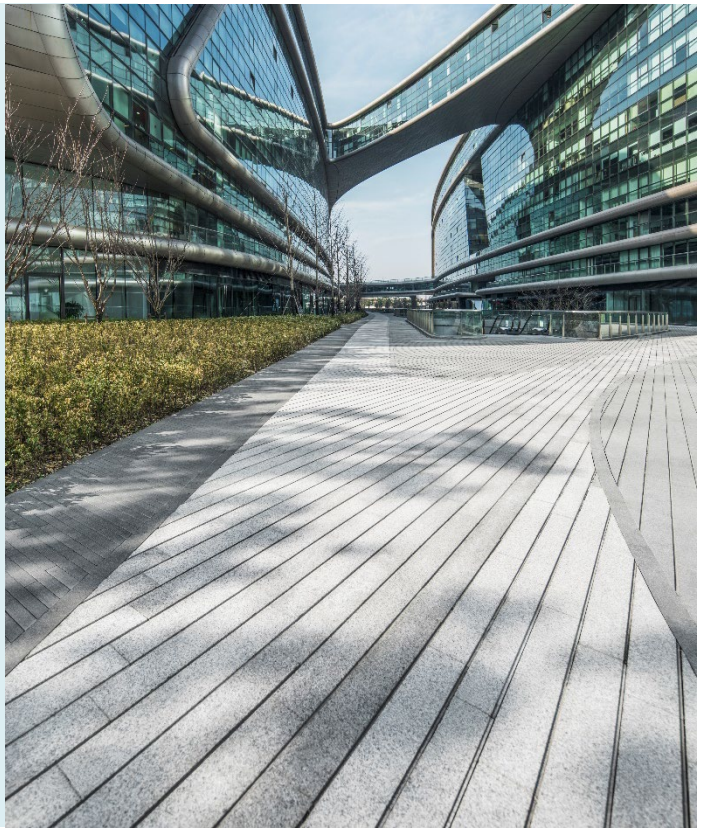
2 Asset and neighborhood quality in Boston, the Bay Area and San Diego are driving leasing activity in a down market

The availability rates in top-tier "core" submarkets (UTC and Torrey Pines in San Deigo, South San Francisco in the Bay Area, and East Cambridge in Boston) have significantly outperformed all other localities in those same metros in recent years. Despite availability spiking to levels never seen before across the lab real estate market, **the best product in the best neighborhoods remains the most sought-after destination for leasing activity.**

Hyperlocality, which takes into account asset quality as well as the specific location within a market, is the key driving factor in leasing and market performance. To wit, when looking at both the premier "core" markets and other lab submarkets established long before the post-COVID runup, we find that the primary determinant of occupancy inflow has been the physical makeup of the building, with a combined net new inflow of users of 2 million s.f. since the start of 2023.

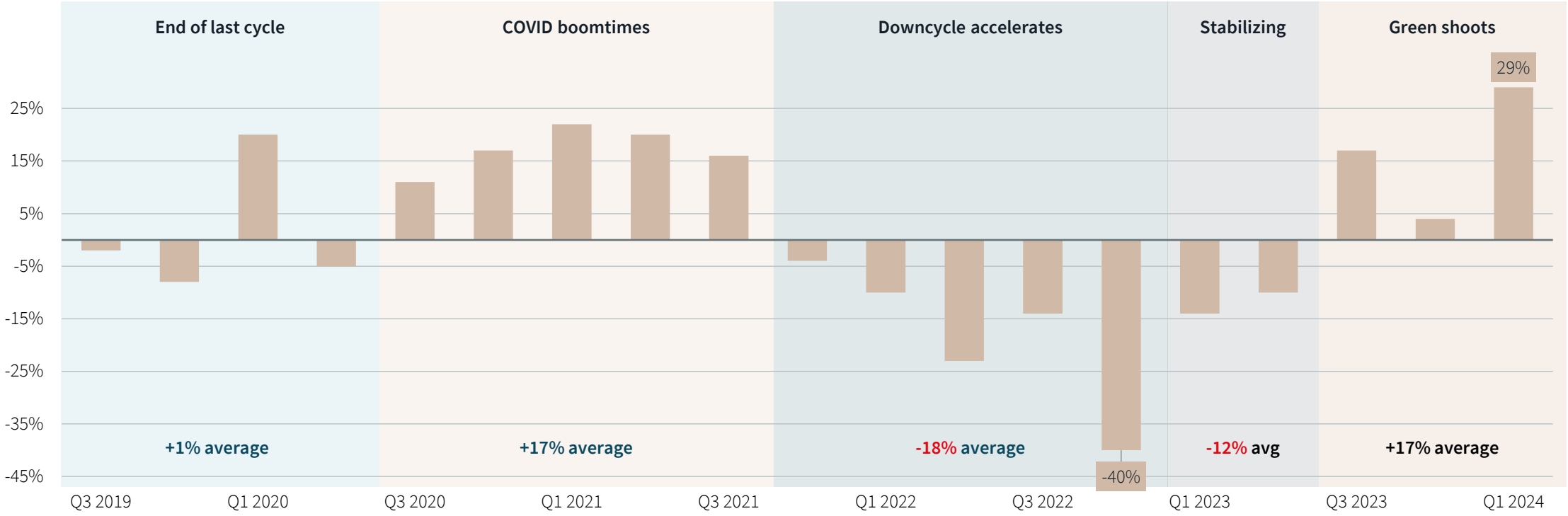
Older product and office conversions that make up Class B product have seen just as much outflow in the same time period, showing that regarding the preference of users in a market replete with quality options, the clear choice has been to upgrade quality of the asset.

Investors unable to obtain access to the core submarkets bet heavily on established submarkets, bringing online additional inventory into ecosystems without significantly growing demand. The result has been a trebling of availability in established submarkets since pre-COVID highs.



3 Demand grows across the U.S., particularly in the Bay Area

QOQ Boston, Bay area and San Diego aggregate lab demand change



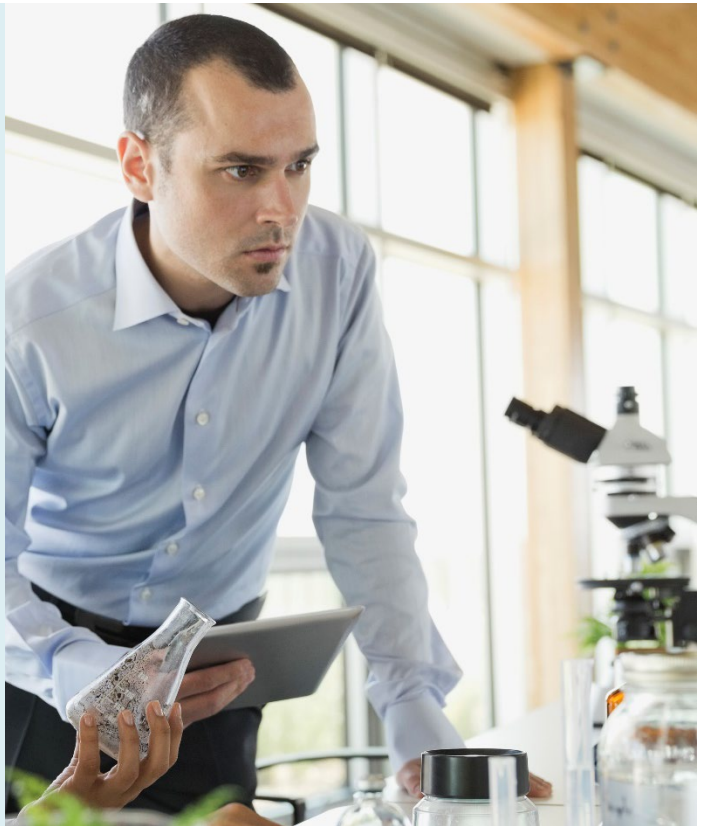
Source: JLL Research; Boston, Bay Area, San Diego

3 Demand grows across the U.S., particularly in the Bay Area

Looking at lab demand, it appears as though the cycle of demand softening has all but ended. **Across the entirety of the U.S. demand has grown (albeit incrementally) since the fall of 2023, up 6.3% across the board in Q1.** Most of this uptick in appetite for space is concentrated in the top three markets, particularly in the Bay Area.

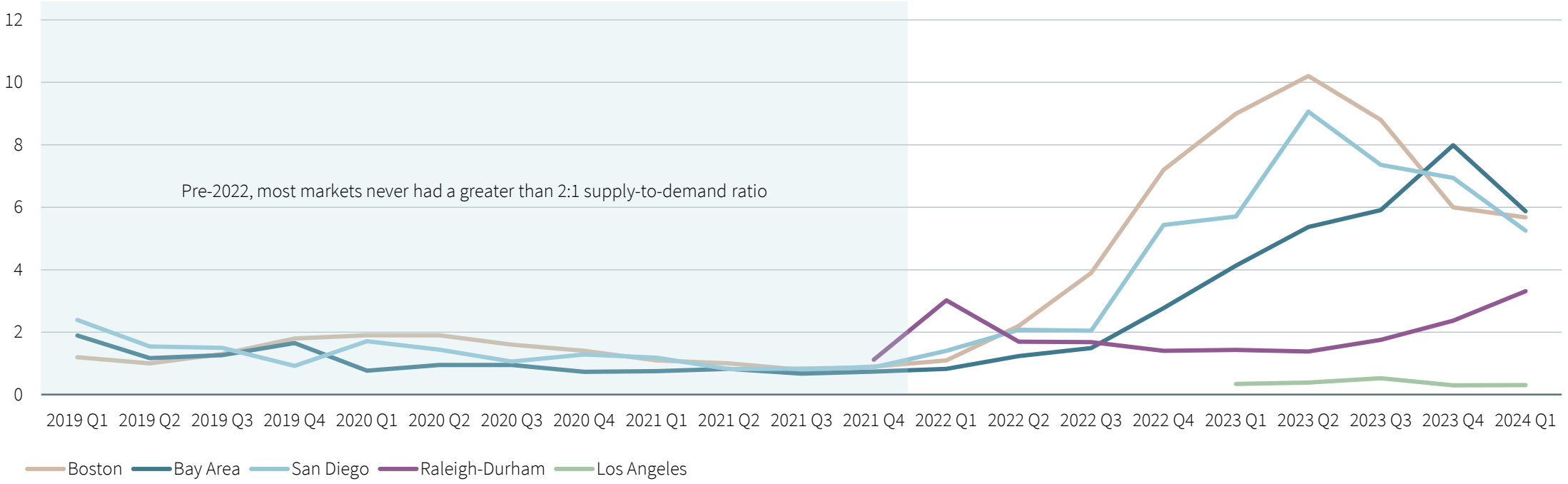
In Q1 2024, quarterly demand increased 29% across the Bay Area, Boston and San Diego combined. The Bay Area alone jumped from a shade under 2 million s.f. of demand at year-end 2023 to 2.7 million s.f. at the end of Q1. This increase was attributable not to one or two massive tenants but to small to midsize start-ups—showing the breadth of new activity. San Diego is a particularly hot market now, largely on the backs of one of its biggest fundraising quarters on record, coupled with heightened big pharma activity that has made the supply-demand dynamics there the best of that in the big three markets.

Aggregate demand across the U.S. is still 55% lower than the highs seen at the end of 2021. For the big three markets, the 6.9 million s.f. of demand today is at par with year-end 2019 levels, before the markets overheated. The chief difference today is that the oversupply in those markets implies an extended opportunity for users to push economics and flow into the abundance of high-quality space.



4 The supply-to-demand ratio is mediating but still has a long road to normalization

R&D supply-to-demand (s.f.) ratio



Source: JLL Research

4 The supply-to-demand ratio is mediating but still has a long road to normalization

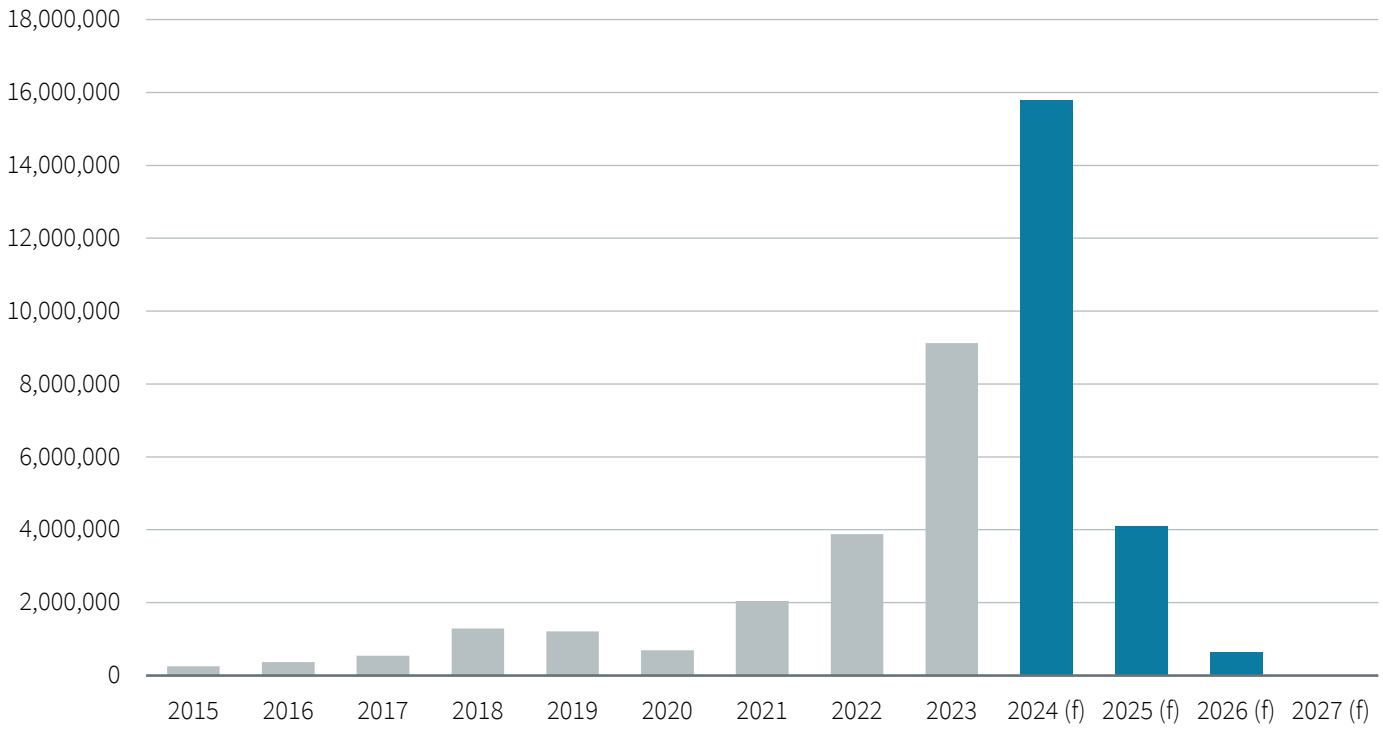
There is a wide array of disequilibrium in the market for lab space in most major markets today. The top three markets (Boston, San Diego and the Bay Area) have followed similar market trajectories in the past two years as the majority of lab users charted a tight funding environment that has severely crimped the ability to sign lease obligations. What was once a market that was for years approximately 1.25:1-1.5:1 in terms of supply-to-demand for years jumped, and by midyear 2023 all markets were between six times and ten times supply-to-demand. With new available space growth slowing (or, in the case of Boston, plateauing) while demand grows, today the markets are clumped together at about 5.5 times the supply than demand.

While there has been a clear oversupply in Boston and the Bay Area, markets like Los Angeles and Raleigh-Durham have managed to maintain supply-demand ratios much more in line with historical levels and that of a functioning market. Raleigh-Durham has seen supply in the cGMP space grow in recent quarters as demand is flat, pushing its ratio to over three for the first time. Los Angeles is a rare example of a market in disequilibrium—this time not enough space is available to growing biotechs. Since tracking in that market began in early 2023, there has generally been 2.5 times more demand circulating the market than available space.

The outlook for the rest of 2024 is such that the ratio will continue to drop in most major markets as new supply contracts considerably and demand continues to grow incrementally. With the ratio today nearly four times greater than from 2019 to 2021, it is likely the market could take three to four years (or more in some submarkets) to return to a market where landlords and tenants have equal leverage in negotiations.

5 Newly added vacancies set to fall precipitously after 2024

Vacant deliveries s.f., U.S.



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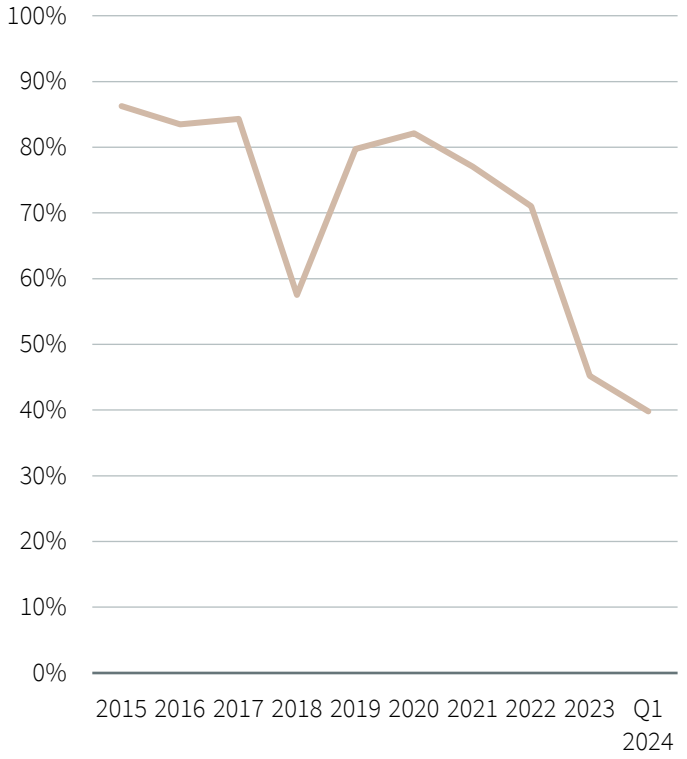
U.S. lab preleased %



5 Newly added vacancies set to fall precipitously after 2024

There is a widespread acknowledgment that the downcycle in life sciences real estate was caused chiefly by a dramatic shift in the macro environment (primarily due to the rapid interest rate increases) coupled with a glut of new supply that was mismatched with shrinking demand. **Today, all indicators are pointing to growth in demand and improving macro fundamentals in the space.** The last hurdle to clear before the lab markets return to something approaching equilibrium is now the oversupply of available space in nearly all markets.

The primary culprit of the vast increase in vacancy in the last two years has not been sublease space (which rose by nearly 6 million s.f. in 2.5 years) but the delivery of new, unleased supply. Just over 13 million s.f. of vacant space was added to the U.S. lab market in 2022 and 2023. This explains two-thirds of the increase in vacancy in that time. 2024 could potentially deliver over 15 million s.f. of new vacancy unless demand materially changes in the next eight months.

The good news from a landlord's perspective is that after the wave of space delivering in 2024 is in the rearview, the new-supply outlook looks quite a lot better for 2025 and beyond. Currently, only 4.7 million s.f. of lab currently underway has the potential to deliver vacant from 2025 into 2027. This respite in new supply will give the market some breathing space and the ability to dig out of the mound of oversupply. Total supply at yearend 2024 could be over 65 million s.f., with aggregate demand sitting at 11.5 million s.f. today.

Lab property outlook

The life sciences real estate sector is at an interesting crossroads in the United States. Venture capital firms have raised record funding that has yet to be deployed. Big pharma has near-record amounts of ammunition for acquisitions and a forthcoming patent cliff that will drive activity in that space. Company creation continued in 2023 despite massive headwinds. And equity values have begun to climb, which emboldened biotechs to tap the markets for secondary offerings at record numbers in Q1.

Our analysis shows that even when armed with growth capital, biotechs are taking less space and taking 9-10 months on average to transact in the market—a marked increase from the five to six months in 2021. This means that even when funding starts to increase substantially, it will likely take two to three quarters to translate into elevated market activity.

Even in this constrained environment, quarterly growth of demand for lab space in the top three markets has averaged 17% in the past three quarters – the same rate seen at its peak in 2021. This momentum is promising, but with supply-to-demand ratios hovering at 5:1 or higher in most markets, it is likely that market conditions will continue to deteriorate in the U.S. through the end of 2024—namely in downward pressure of occupancy and rents.

With a fast-improving supply outlook beyond 2024 coupled with demand fundamentals looking good, the lab real estate recovery will likely take years in some submarkets and come much sooner than anticipated in others—namely established markets with a critical mass of preexisting users and high-quality lab stock.

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