South Duvall
Commercial Real Estate Investments

2019 Q1

THE ANALYST

MARYLAND CAPITAL MARKET OVERVIEW

GROWTH OF SMALL LIFE SCIENCE COMPANIES

At South Duvall, we are trying to solve real estate problems for life science and research companies. We had noticed that in the Washington DC metro Area there were not good solutions for smaller life science tenants. We sought to solve that problem with the delivery of 704 Quince Orchard Road. However, we wondered why this dynamic existed.

First, Life Science Real Estate has two distinctly different types of tenants, cash flowing tenants and pre-cash flow tenants. Cash Flowing tenants have always had an easier time solving their real estate needs. Banks can underwrite their cash flows coming from drugs they produce, research contracts, manufacturing contracts or licenses they have. Pre-cash flow tenants are largely small companies that have a piece of intellectual property. Normally they are being funded by a founder or have received one or two rounds of venture capital. They are burning through cash advancing their research.

Real Estate for these pre cash flow Life Science tenants is often difficult to solve for. Does there need to be a fresh air system on the roof? Does there need to be a back up generator with many outlets connected to it? Who is paying for these items, the landlord or the tenant? Would the building support these items, can we run shafts to the roof easily? Due to these questions and costs, smaller, pre-cash flow tenants rarely have new spaces created for them. Furthermore, despite all the investment into their real estate, these pre-cash flow tenants do not want to be in their space for very long. They want to grow. Ideally, they will get additional funding or advance to clinical trials and require more space. Their existing lease could quickly become a liability and their investments into that space could become a sunk cost.

Lastly, pre-cash flow tenants have become a greater cause for growth in the industry and thus, have an increase in demand for real estate. Per Deloitte, Research and Development returns are falling to their lowest levels in nine years for 12 large cap biopharma companies, at 1.9% in 2018, compared to 10.1% in 2010. Small, niche companies are driving innovation and developing most new drugs. Large pharma companies are increasingly outsourcing their R&D. There are more than 250 startups focused on gene-based therapeutic solutions. Venture capital flows to the Life Science Sector set new records. According to NVCA – There was a record $16.6 Billion in VC Funding for US Life Sciences in 2017. Only to have a new record set of 23.3 Billion in 2018 (https://pitchbook.com/news/articles/18-charts-to-illustrate-us-vc-in-2018). Where does all this funding go? Overwhelmingly to pre-cash flow companies with smaller real estate demands.

This trend is expected to continue as small firms can use many technological breakthroughs to solve very specific health problems. Real Estate Investors that can solve these real estate demands will be well positioned over the next decade.

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