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GOODWIN

PROPSCI - An Underestimated Real Estate Asset Class in Germany

World affairs are currently clouded by the global COVID-19 pandemic. In a very short period of time, approximately 191 vaccine projects have been launched according to the World Health Organization (WHO). Among the countries with a particularly large number of projects, approximately twenty in total, is Germany. This already displays the role Germany holds in the global life science market. Germany is known for its established and leading life science companies such as Bayer and Merck, but there are a number of other German life science companies that show potential to establish themselves on the world market such as BioNTech and CureVec.

Moreover, a new and constantly growing generation of start-up companies has emerged in Germany in the field of life sciences, constituting 8.5% of all German startups established in 2019. The life sciences field therefore makes up the third strongest growth area in the German start-up scene. The global life sciences products market was estimated to be valued at more than $2.5 billion USD in 2015 and is predicted to cultivate to approximately $4.2 billion USD by 2024. Germany is the fourth largest pharmaceutical market globally, after the U.S., Japan and France. One in six jobs in Germany is linked to the healthcare sector, which generates an economic footprint of $775 billion USD, accounting for an estimate of 12% of Germany's GDP in 2020.

Digital health products alone are expected to be 8% of the overall spending in the healthcare industry in 2025, amounting to EUR 38 billion in Germany. Germany is proving to be an early adaptor with almost half of the population using their mobile devices for personal health purposes, thus contributing to the growth of the health-tech industry. Following this, Germany undeniably holds one of the front seats in the field of life sciences.

Germany is also taking a lead on developing a vaccine against COVID-19 and laboratory and research capacities are in very high demand nationwide. The demand for suitable space to develop medicine, diagnostic tests, medical devices and biotech applications is sought after even more than prior to the pandemic. Although Germany is one of leading forces in life sciences globally while being extremely innovative at the same time, the German real estate industry is so far behind the curve on catching up to the coherently developing need for propsci space.

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SURPLUS DEMAND FOR PROPSCI IN GERMANY

Although the demand for personnel as well as space in the life sciences sector has grown continuously in recent years, the German market fails to identify propsci as an asset class. The limited supply on the private real estate market in Germany regarding the rental of laboratories creates a dependence on universities or publicly subsidized labs for many scientists who strive to develop, produce and market medicines, diagnostic tests, medical devices, fertilizers or new biotech applications.

In return for the provision of premises, research equipment or human resources, these universities often have a first call on the granting of claims on the ideas developed by the scientists. Patents and industrial property rights can then regularly only be registered in favor of the respective university. Therefore, it is often difficult to set up and run a company independently when the founding researchers have to buy back their own developments from the university or college before being able to market their ideas independently.

In most cases, this is not only a cumbersome process, but also confronts the scientists with a financial overload. Additionally, the constantly increasing demand for appropriate premises no longer can be adequately met by German universities.

SUPPLY CONSTRAINT AND THE CORRESPONDING INVISIBILITY OF THE PROPSCI MARKET IN GERMANY

This lack of propsci supply not only creates a mismatch between demand and supply, but also entails two other effects: (i) the emigration of many scientists, mainly to the U.S. to use the suitable and available premises there in order to try to enter the market with their own ideas, including the freedom to successfully self-market their ideas, and (ii) furthermore, it has recently been observed that the established life sciences companies in Germany have identified the lack of needs-based premises for scientists and, like universities, are making suitable premises available for start-ups and specialized scientists who in return promote the research and development of new technologies for those companies.

Similarly to the situation arising with facilities offered by universities, the scientists give up their right to self-market their own ideas.

Lack of supply of needs-based premises for life sciences companies in Germany should be sufficiently visible to lead to a certain market response, although not yet on the private real estate side but primarily on the side of public-sector providers such as cities and states.

Although "life sciences cluster"-like areas have been established in Germany in the form of research and technology parks, they are much smaller than in the U.S. Companies, institutes, facilities and service providers from the fields of biomedicine, biotechnology, environmental technology and medical technology are located there. Examples of research and technology parks located in Germany are the Weinberg Campus in Halle (Saale) with the affiliated Martin Luther University, as well as a Max Planck and Frauenhofer Institute, the Science and Technology Park Adlershof in Berlin-Brandenburg and the Technology Park in Heidelberg with a focus on biotech companies.

This proves that the asset class propsci is slowly emerging in the German real estate market. However it also shows that the establishment of propsci in Germany is currently solely led by public law entities.

In contrast to the U.S. where the propsci market is concentrated in and around Boston, San Francisco and other major cities, the emerging propsci market in Germany is still decentralized. This decentralization can at the same time be explained and considered as an opportunity, as two leading universities in the field of life sciences are located in Berlin and Heidelberg. Thus, this is where the personnel and the know-how required for the creation of life science clusters can be found.

Consequently it makes sense to pull further technology-clusters out of the ground in vibrant university cities with prestigious life science faculties, such as in Göttingen and Halle, and to support private investors in developing more technology parks in the cities emerging as life sciences hubs already, such as Berlin.

PROPSCI MARKET PROSPECTS IN GERMANY

Aside from an apparent mismatch of demand and supply in the German prosci market which should attract investors with tempting profit margins, investors have not discovered the market potential yet or respond hesitantly to it with regard to the legal restrictions of the German Construction Planning Law and other restrictions and their lack of experience.

Since multiple initial developments in the propsci asset class in Germany had been driven forward by institutions under public law, private real estate companies do not yet have an equal level of experience in developing propsci buildings, or renting them out. In line with this, the flow of investment is clearly still limited.

Foreign investors might, although experienced, face the challenge of being confronted with numerous planning law and building regulations which cause the approval procedure for a propsci building in Germany to be lengthy and complex. However, the associated challenges can be well tackled if investors cooperate with legal experts experienced in the real estate sector and open to service the life sciences companies' needs within the legal framework of the German construction planning and building regulations.

The private real estate industry in Germany has a tremendous opportunity for growth and the chance to position itself as a central player in the global market for propsci. A short-term market entry would come with an insurmountable advance. A market entry could be executed implementing various models. Two significant models are outlined below:

- Firstly, a market entry can be realized by identifying the need for a propsci building and the appropriate tenants in advance, providing them with shell and core spaces, obliging the tenants to fit-out the rental spaces according to their own needs and requirements at their own expense. This model would circumvent the issue of limited experience in the furnishing and planning of life sciences facilities. Setting up appropriate lease agreements can be easily handled by German real estate lawyers.

- Secondly, another possibility to enter the market would be to offer a completely finished building tailored to the needs of the respective tenants. Achieving this would mean to cooperate with operating companies, for example in the form of a joint venture, which provides the technical know-how for the operation of such a building. This know-how would then be contributed to the project by an operating company, set up to act similarly to "propsci asset management" companies found in the U.S. In this model, German real estate lawyers would set up the legal relationships of the involved parties and draw up the rental contracts. Such a joint venture would promote a calculable and financially plannable realization of a propsci project in Germany.

Regardless which model would be favored, unarguably there is a great opportunity for investors to position and establish themselves as pioneers on the propsci field in Germany and cultivate momentum for the emerging propsci asset class.

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