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Dearth of small firms concerns bio landlords

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By Brendan Carroll

From some perspectives, it doesn’t seem like things can get any better for the Massachusetts biotechnology industry and owners of the 12 million square feet of biotechnology-focused commercial real estate.

With nearly 1 million square feet of positive absorption over the past four quarters, a record level of venture capital investment, the entrance of two of the world’s largest industry players and four new publicly traded companies, the description seems somewhat akin to that of certain segments of high tech that prospered in 1999 and 2000.

However, there are 2 million square feet available in the market, and prospective landlords are faced with a disturbing new reality: a lack of early-stage companies looking to take the numerous 10,000 to 15,000 square-foot blocks of space off the market.

Venture capital investment in Massachusetts-based biotechnology-related companies has increased steadily over the past eight years and notably over the past three years, when VC investment in Massachusetts plummeted nearly 70 percent overall.

Over the past five years, the average VC investment size in a Massachusetts-based biotechnology firm has increased 115 percent, more than seven times the 17 percent increase in all Massachusetts-based companies. While earlier-stage investments in biotechnology companies made years ago enabled today’s mid- to later-stage investment opportunities, the growing industry is confronting hesitation on the part of VCs when considering earlier-stage investments.

Their initial investments created an industry of early-stage biotechnology firms with smaller real estate requirements, normally up to 20,000 square feet. Certain of these companies’ successes created larger firms, some of which are now in later stages of venture capital funding and some of which are now public. The funding requirements of the later stage companies are higher, though the investment opportunities are less risky, as they are

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generally involved in later phases of clinical trials testing.

Venture capital has flowed at record levels to later-stage biotechnology firms, though a relatively risk-averse mentality has dramatically slowed the flow to the earlier-stage companies.

This risk-averse mentality has even permeated corporate decision-making, as more established biotechnology firms have abandoned some early-stage research efforts and redeployed those resources to later-stage research and testing that is more likely to yield near term revenue.

The cumulative effect has been reflected in the Massachusetts Clinical Trials Index, which shows consistent growth in area clinical trials testing for Phases II through IV but sluggish growth in Phase I, and even a decline in Phase I for the latest six-month period, ended Sept. 30.

The general lack of capital flowing to early-stage companies and testing for biotechnology, however, is expected to be a relatively short blip in capital availability, as a lack of Phase I clinical trials will ultimately slow the whole drug research pipeline.

Venture capitalists will begin to fill in the gap left by the current preference for later-stage companies, and companies at all stages will redeploy capital for earlier-stage research. In the case of later-stage companies, some of this capital will actually come from the successes of pharmaceutical products currently in testing.

However, it is unclear how long it will take for the investment dynamic to change. The voters of California, viewed by many as Massachusetts' main competitor for biotechnology startups, have just passed Proposition 71, providing up to $3 billion in funding for stem cell research programs over the next 10 years. Proposition 71 may serve as the near-term answer for many early-stage biotechnology companies and initiatives, and it serves as a serious threat to Massachusetts in its ability to attract early-stage biotechnology companies unable to find venture capital financing on acceptable terms.

Until an upswing in early-stage biotech investment, the area's inventory of biotechnology-focused commercial real estate will continue to be driven by moves on the part of larger companies and institutions, just as it had been during the past 12 months.

Of the 1 million square feet of positive absorption in that period, nearly all of it can be attributed to the entrance of Merck and Novartis, as they occupied space developed for them in Boston and Cambridge, respectively. The Broad Institute considered taking occupancy of the building Lyme Properties developed in 2003 for Vertex but ultimately decided on developing their own build-to-suit facility at Cambridge Center.

It is rumored that two other large biotechnology-related users are in the market, though they may be more likely to have their own spaces built than to occupy the market's two large vacancies.

The biotechnology industry remains an area of growth within the economy, and many of today's concerns are the result of a property type that has grown in inventory 22 percent over the past three years. The long-term prognosis is favorable, and Greater Boston's status as a leading center of research positions it well as early-stage ventures regain popularity within the investment community.

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