Overcoming The Challenges Of Financing Biomedical Facilities

Written by Stan Wendzel MBA, CPA, LEED AP

BRI BioRealty, Inc.

Facility Capital Solutions

The Biomedical sector is trying hard to become a favorite on Wall Street, but it’s been a tough road. That’s surprising since biomedical discoveries and inventions are helping to fuel economic growth and they are credited with solving many of society’s biggest challenges. Perhaps the reason for the struggle is that these advances come attached to enormous costs including R&D and staff salaries. For many biomedical companies that are either just entering the start-up phase, or are at their mid-stage of growth, another crippling cost that impedes profitability are the costs related to buying and building their real estate facilities.

Biomedical properties require much higher capital investment than does more traditional office or manufacturing space. These higher costs are the result of specialized needs such as total systems redundancy, specialized HVAC systems, extensive process piping, heavier floor loads, special purpose rooms such as clean rooms, and higher than normal electrical capacity.

Depending upon the type of biomedical research and manufacturing that an organization is involved with, as well as where in the world those facilities are going to be located, biomedical real estate costs can run as high as $1,000 per square foot or more. And that level of costs pose a great threat to the biomedical industry as a whole.

This is especially true for early and mid-stage firms with an unproven track record and limited opportunities for attracting financing from either traditional lending sources or VC firms. In general the biomedical industry is under served, and even avoided, by many traditional investors because of the high barriers to entry and exit as well as the issues revolving around risk-adjusted yields. For many, the risk is just too great for the potential rewards.

To make matters worse, very few real estate companies are willing to make the kinds of improvements that biomedical companies require, and most real estate investing companies have investment limits that top out at around $350 per square foot. Left up to the biomedical company to make up for shortfalls of $650 per square foot and higher, many of them are delaying new facilities which may hinder product development or worse they are selling their technology before they even have a chance to bring it to market.

Even the fortunate few companies that are able to arrange for funding often find themselves strapped for operating and R&D capital after their real estate costs are taken care of. This leaves them in a “property rich – product poor” position which is only slightly better than never having been able to open their facility to begin with.

So, what options exist for cash-strapped biomeds that need a place to call home?

Many of the more financially savvy companies are looking at leasing property rather than owning it. Whether it is leasing a new facility outright, or selling their current facility and leasing it back this alternative is becoming increasingly popular. This option is hampered, however, by the fact that the average real estate company doesn't have the technical or financial capabilities necessary to be a viable real estate partner in these types of transactions.

This money and technology gap has spawned an entirely new type of real estate leasing industry that specializes in the unique needs of the biomedical industry. These few organizations are staffed by industry experts who understand the real estate needs of the biomedical industry and who realize that the road to profitability for companies in that market may be a long and rocky one.

The biomedical companies who choose to partner with these real estate specialists benefit in many ways. Not only do they gain the opportunity to work with leasing professionals who understand both their needs and their challenges, but they free up precious cash that would normally be tied up in the property they own and instead use that cash to fund R&D and other operational costs.

Beyond the improved cash position, leasing results in an almost immediate improvement to a company's balance sheet by increasing working capital and reducing debt and, at the same time, enhancing key financial ratios, such as their current ratio and debt-to-capitalization. If the company is public, these improvements often result in a bump in their stock price after the facility assets are moved off of their books. Not only are earnings improved, but Wall Street views both leasing and focusing on core business activities as favorable.

On-going cash flow is dramatically improved due to the fact that most facility improvements are typically financed over a term as short as 3 to 7 years, but improvements that are financed as part of a real estate leasing agreement can financed over a period of 15 years or longer.

In short, structuring a leasing deal through a qualified biomedical real estate investor is a marked improvement over the current practice of soliciting capital from VC's, undertaking a public or private equity offering or convertible debt offering, or seeking financing from traditional lending sources.

Although some of the few biomedical real estate companies in existence operate as a REIT (Real Estate Investment Trust), which provides favorable tax treatment under the U.S. Tax Code, REIT's are required to comply with strict rules that limit their ability to provide capital to early stage biomedical firms. That's why biomedical companies need to pay close attention to their potential real estate leasing partner to make sure that their growth will not be hampered by the restrictive environment that a REIT is forced to operate under.

Biomedical real estate companies that are not structured as a REIT operate under the same premise of providing expertise in acquiring, developing, owning, leasing and managing laboratory, office, warehouse, and manufacturing space for the biomedical industry, but are not subject to the same rules as a REIT. Therefore the wise tenant seeking to maximize its advantages through leasing might consider a non-public REIT first.

Many of the more successful biomedical real estate companies are focusing their offerings in the areas of the U.S. that are especially attractive to the biotechnology industry. These areas include San Diego, San Francisco, Los Angeles, Seattle, Washington D.C./Baltimore, Philadelphia, New York/New Jersey/Connecticut, Boston and Raleigh/Durham. But the biomedical industry is much broader than merely biotech and as it continues to spread out to other states some real estate companies are following. Certain real estate firms are even pursuing leasing opportunities with biomedical companies located elsewhere in the world. As a biomedical company matures and its need for either expansion or low cost manufacturing or R&D increases, this broad operating platform offered by some real estate firms provides added convenience.

For many biomedical companies the difference between the success and failure is measured by their cash burn rate. With product release lead times being so long, biomedical businesses cannot afford to spend money in an unresponsive manner.

Utilizing the services of a biomedical real estate investment firm is an attractive alternative to other financing options. In many instances, that alternative could possibly be a life-giving opportunity for biomedical research companies, regardless of their development stage, to get the financial helping hand they need without acquiring more crippling debt.