

**CBRE**

# **TEESSIDE PENSION FUND**

## *Quarterly Portfolio Strategy Report*

17<sup>TH</sup> APRIL – 9<sup>TH</sup> AUGUST 2017

PREPARED FOR



# CONTENTS

1. EXECUTIVE SUMMARY
2. ECONOMIC PERFORMANCE AND PROPERTY MARKET
3. PORTFOLIO STRATEGY AND FORECASTING
4. PORTFOLIO ACTIVITY



# 1 EXECUTIVE SUMMARY

# EXECUTIVE SUMMARY

## Portfolio Strategy

You have advised us of your objective to increase the property portfolio towards £250m over a 2-3 year period in a risk controlled manner.

### CBRE Recommended Strategy

- To diversify the portfolio by spread of property types, unit sizes, occupier businesses, quality, income expiry and geographical regions.
- To make acquisitions and disposals to balance the lease expiries within the portfolio.
- Our strategy envisages a long term overweight position in industrial and retail. We also advocate an underweight position in offices.
- Acquire prime, well-let properties, together with some RPI linked assets targeting the industrial, retail and food store sectors.
- Keep the vacancy rate consistently lower than average whilst reducing income risk in particular years.

SECTOR	CURRENT	TARGET
Industrial	36.4%	25%
Retail Warehouse	37.7%	25%
High Street Retail	12.8%	25%
Long Income/ Supermarkets	9.5%	20%
Offices	3.6%	5%
	100%	100%

# EXECUTIVE SUMMARY

## Portfolio Profile

### Current portfolio

- At 30<sup>th</sup> June, the portfolio comprised 24 mixed-use properties located throughout the UK with a value of £206.65m. This reflects an overall Net Initial Yield of 5.15%, and an Equivalent Yield of 5.84%.
- The portfolio is principally in prime and good secondary assets. High Street retail, retail warehouse and industrial, comprise 86.9% of the portfolio by capital value. There are 61 demises and a total net internal area of 1,301,470 sq ft.
- The weighted average unexpired term is 9.1 years to the earlier of first break or expiry, and 10.5 years to expiry, ignoring break dates.
- The portfolio also has the following characteristics:
  - The vacancy rate is currently 1.1% of Estimated Rental Value, the portfolio is fully let. The IPD Quarterly Index Q2 2017 average void is currently 8.1% by ERV.
  - The top ten tenants constitute 52% of the total gross annual income of the portfolio, while the top 20 tenants constitute 77.2%.
  - Current gross passing rent is £11,324,499 per annum, against a gross current market rent of £12,238,839 per annum.

# EXECUTIVE SUMMARY

## Portfolio Activity

### Portfolio activity

#### Sales

- There were no sales in Q2 2017

#### Acquisitions

- There were no acquisitions in Q2 2017.

# EXECUTIVE SUMMARY

## Portfolio Activity And Strategy

### Portfolio arrears at 3<sup>rd</sup> Aug 2017

The total Collectable Arrears on the entire portfolio is £62,397.68 as at 3<sup>rd</sup> August 2017. The Collectable Arrears exclude the following:

- Tenants that pay their quarterly rent in monthly instalments and are up-to-date with payments (Aurum Group Ltd, Multiyork Furniture Limited and J.F. Stone Investments Ltd).
- Tenants that are insolvent (99p Stores Limited at Cirencester, which on 4<sup>th</sup> August amounted to £94,978.22 in isolated arrears).
- Tenants that have overall credit balances on their accounts.
- New charges that have been raised in the last 28 days.

### Of the Collectable Arrears, 76.4% (£47,711.45) relate to the following 4 accounts:

- Pets at Home (Dorchester) - Total arrears of £14,975.02 (24.0% of collectable arrears). This relates solely to a service charge dispute. Freeths are instructed and we are liaising with the tenant to resolve the matter.
- Pets at Home (Cirencester) – Total arrears of £14,730.53 (23.6% of collectable arrears). This mainly relates to their monthly rent payment which was due on 28th July. This sum is being chased.
- Global Logistics Central Limited – Total arrears of £11,750.00 (18.8% of collectable arrears). This relates solely to their monthly rent payment which was due on 1st August. This sum is being chased.
- B&Q (Arbroath) – Total arrears of £6,255.90 (10.0% of collectable arrears). This solely relates to the quarterly service charge, due on 28th February. We have now established that this sum has been charged at the incorrect rate. This is about to be credited in full and re-raised for the sum of £5,545.94, at which point the tenant will make full payment.

The remaining 23.6% of the Collectable Arrears (£14,686.23) relate to 20 different tenant accounts; all of which are being chased.

# EXECUTIVE SUMMARY

## Rent Collection Statistics

Title	Rent Due 24 June	Collectable Rent	Targets	92.00%	96.00%	98.00%	99.00%	Payment after 22/07/2017	Difference
			Quarter Date up to and including 24/06/2017	Week 1 up to and including 01/07/2017	Week 2 up to and including 08/07/2017	Week 3 up to and including 15/07/2017	Week 4 up to and including 22/07/2017		
	2,893,122.33	2,841,837.33	2,417,200.51	223,840.08	141,749.66	4,250.00	0.00	54,793.50	3.58
Non Collectable Total		51,285.00							
Collections Including non collectables			83.5%	91.3%	96.2%	96.3%	96.3%	98.2%	
Collections Excluding non collectables			85.1%	92.9%	97.9%	98.1%	98.1%	100.0%	

These figures relate to rents that only became due on the June English Quarter Day (24<sup>th</sup> June 2017).

The non collectable sum (£51,285) relates to the three tenants who pay rent on a monthly basis.

They are fully up to date with all payments due.



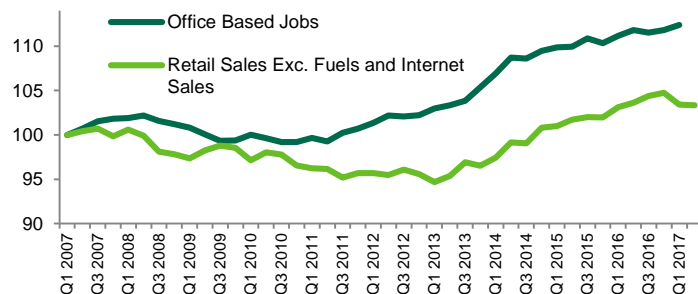
## 2 ECONOMIC PERFORMANCE AND PROPERTY MARKET

# PROPERTY MARKET & SECTOR FORECASTS

## Economic Performance Q2 2017

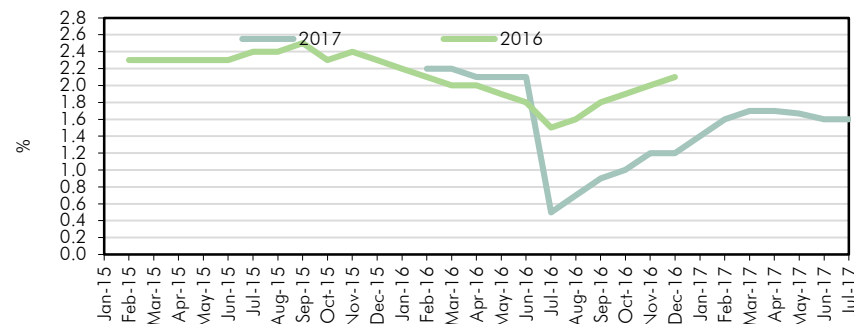
- Q2 2017 GDP is estimated to have grown by 0.3% over the quarter. In 2016, the main driver of growth had been the consumer, with higher borrowing pushing the savings rate to its lowest level since records began. However, manufacturing performance, as measured by the Purchasing Manager's Index (PMI), is currently at a three year high and contributing positively to overall economic performance.
- Retail sales grew 1.5% in Q2 across all store types, recovering from a fall in Q1. Inflation rose through April and May to 2.9%, falling in June to 2.6%. The main factors in the June decrease were falling prices for motor fuels and certain recreational and cultural goods and services. Current inflation forecasts continue to exceed the Bank of England's target of 2%.
- The labour market remains tight and unemployment sits at 4.5%. Surveys show increases in jobs, albeit at a slower pace than recent years. In our view, soft growth and falling real wages will delay any interest rate rise.

**Economic Drivers of Commercial Property Demand**



Source: CBRE, Oxford Economics, ONS

**Evolution of UK GDP Growth Forecasts**



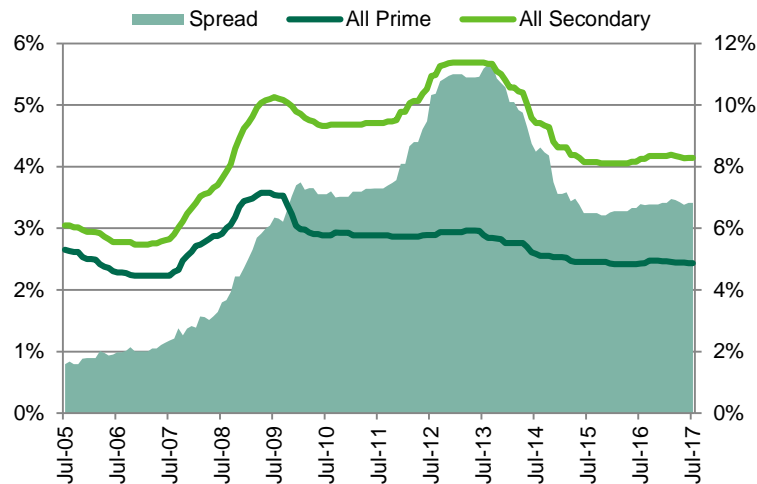
Source: HM Treasury Consensus

# PROPERTY MARKET & SECTOR FORECASTS

## Property Market Q2 2017

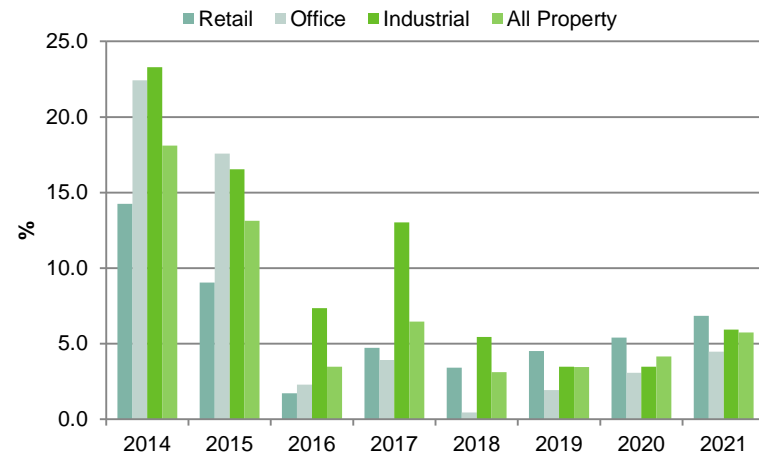
- Total Returns for All UK Property were 5.0% for the period Q2 2016 to Q2 2017\*. Capital values for Q2 recorded a 1.2% increase over the quarter.
- Industrials again recorded a strong performance compared with other sectors in Q2 2017. Total return and capital value growth were 4.0% and 2.6% respectively for the quarter.
- Rental values increased by 0.3% in the second quarter of 2017. Rental value growth for the same period in 2016 was 0.6%. The highest rental value growth in Q2 was recorded for Industrials at 0.9%.

Prime Vs Secondary All Property Yields (excl. Central London)



Source: CBRE Monthly Yields, July 2017

Property Total Returns



Source: IPD, CBRE, July 2017

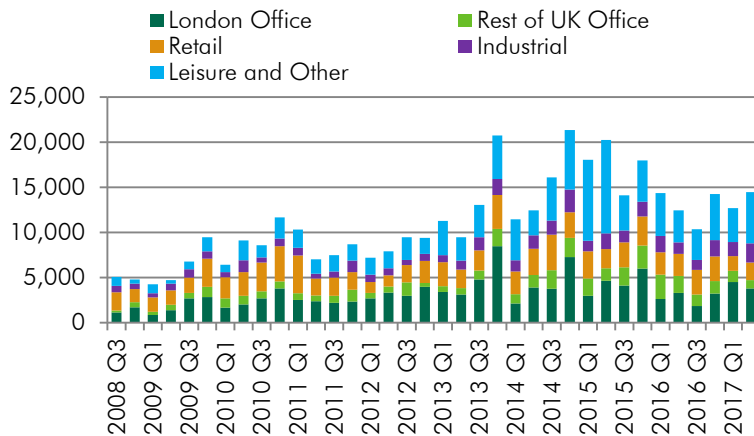
\* Based on CBRE Monthly Index, all property total returns Jun 2017

# PROPERTY MARKET & SECTOR FORECASTS

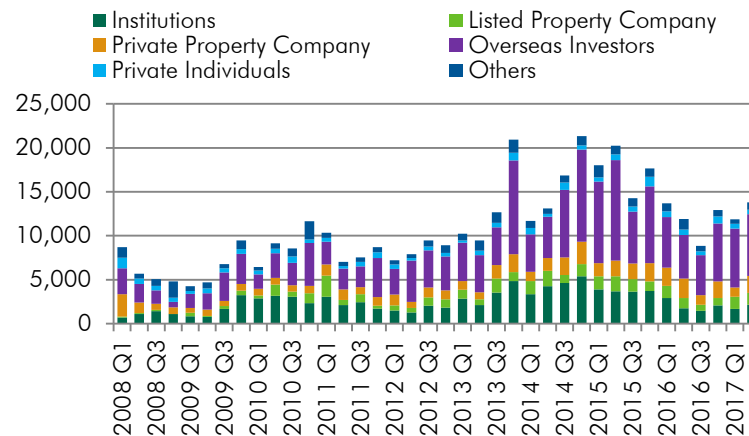
## Property Market Q2 2017 Transactions

- In Q2 2017 investors recorded a total transaction value for 'All Property' of £14.5bn. This performance is higher than Q2 2016 (£12.4bn), although 2016's results were affected by the lead up to, and results of, the EU referendum.
- In Q2, 51% of investors were overseas investors, which demonstrates a drop from the previous Quarter's reported figure of 57%. The continuation of overseas investor interest has likely been driven in part by the devaluation of Sterling following the 'Brexit' vote. UK institutions recorded market participation of 15% in Q2 2017 which amounts to c. £2.1bn of investment. This is roughly in line with the previous Quarter's reported figure of 14%.
- Investment transactions for 'All Offices' totalled £4.7bn in Q2 2017. Central London office investment recorded £3.8bn in investment, accounting for c.80% of total office investment for the quarter. The highest investment during this quarter was the purchase of 78 Cannon St for £485m.
- The Industrial sector saw £2.1bn in transaction activity in Q2 2017, reflecting the growing interest in this sector. The biggest deal of Q2 was the purchase of the Ultrabox Portfolio for £286m.
- Retail transactions totalled £1.9bn for the quarter, with LandSec purchasing a factory outlet portfolio for £332.5m in May 2017.

**Commercial Property Investment Transactions (£millions)**



Source: : CBRE, Property Data, July 2017



Source: CBRE, Property Data, July 2017

# PROPERTY MARKET AND SECTOR FORECASTS

## UK Returns Forecast

	2016	Forecast *					2017-2021
		2017	2018	2019	2020	2021	
<b>Total return: % per year</b>							
Retail	1.7	4.7	3.4	4.5	5.4	6.8	5.0
Office	2.3	3.9	0.4	1.9	3.1	4.5	2.8
Industrial	7.3	13.0	5.4	3.5	3.5	5.9	6.2
All Property	3.5	6.5	3.1	3.4	4.1	5.7	4.6
<b>Income return: % per year</b>							
Retail	5.2	5.2	5.3	5.3	5.3	5.3	5.3
Office	4.1	4.1	4.2	4.3	4.3	4.2	4.2
Industrial	5.3	5.2	5.1	5.1	5.2	5.2	5.2
All Property	4.9	4.8	4.7	4.8	4.8	5.8	4.8
<b>Capital growth: % per year</b>							
Retail	-3.3	-0.5	-1.8	-0.7	0.1	1.5	-0.3
Office	-1.7	-0.2	-3.6	-2.2	-1.1	0.2	-1.4
Industrial	2.0	7.4	0.3	-1.6	-1.6	0.6	1.0
All Property	-1.3	1.6	-1.6	-1.3	-0.6	0.9	-0.2
<b>Nominal rental value growth: % per year</b>							
Retail	1.0	0.5	0.1	0.6	1.3	2.2	0.9
Office	2.9	-0.9	-3.0	-1.6	-0.5	0.4	-1.1
Industrial	3.5	4.2	2.8	1.7	1.4	1.9	2.4
All Property	2.1	0.9	-0.2	0.2	0.8	1.6	0.6
<b>Equivalent Yields - % at end year</b>							
Retail	5.7	5.9	6.0	6.0	6.0	5.9	0.2
Office	6.0	6.1	6.2	6.2	6.2	6.2	0.2
Industrial	6.3	6.0	6.0	6.2	6.2	6.2	-0.1
All Property	5.9	5.9	5.9	5.9	6.0	5.9	0.1
<b>Change pp</b>							
Retail							
Office							
Industrial							
All Property							

\* Forecast figures based on Q1 2017 quarterly valuations

Source: CBRE, May 2017

The level of uncertainty within the economy means that the majority of forecasts lean towards a downside risk. Our property forecasts are based on Oxford Economics' economic forecasts

All Property Total returns registered 3.5% in 2016, surprising on the upside. 2017 is expected to register returns of 6.5%. Over the forecast horizon, All Property Total returns are expected to range from 3% to 6%.

All sectors showed positive returns in 2016, and the Industrial sector registered the highest total returns among the sectors. Industrial is expected to outperform both retail and office until 2019, at which point retail is expected to perform the best.

Capital value growth for all sectors slowed in 2016, with Industrial still outperforming other sectors. Both slower rental growth as well as increases in yields contributed to this slowdown.

The Industrial sector still continues to outperform other sectors with relatively strong rental growth in 2016; projected to be 4.2% in 2017



# 3 PORTFOLIO STRATEGY AND FORECASTING

# PORTFOLIO STRATEGY AND FORECASTING

## Portfolio Strategy

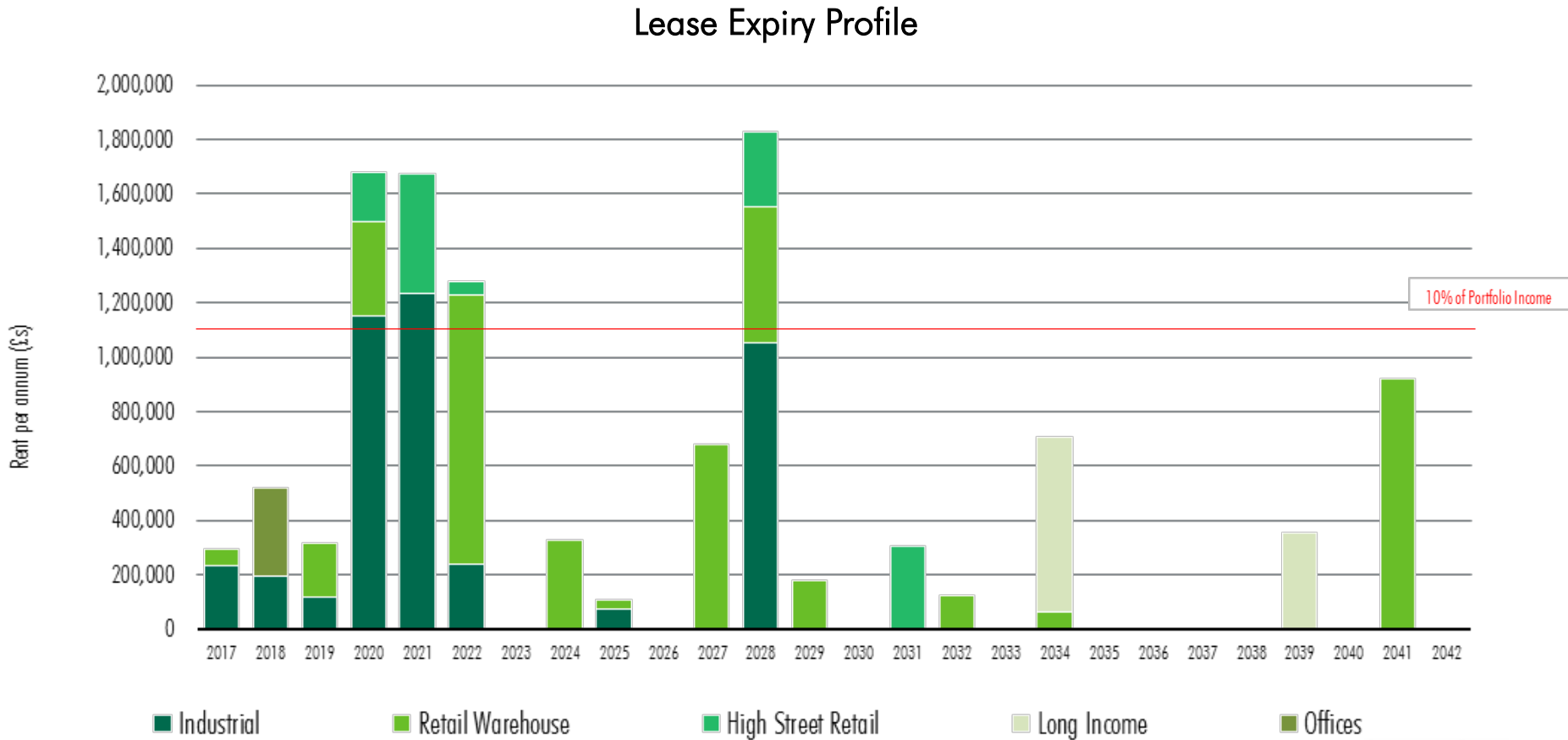
### TOP DOWN STRATEGY

- The Teesside Pension Fund was valued at approximately £3.89bn (June 2017). The direct property portfolio held by the Fund was valued at £206.65m (June 2017). The indirect property portfolio was valued at £43.48m (June 2017). Therefore, the Fund's real estate exposure (6.4% of assets) is significantly underweight, compared with similar pension funds.
- We will seek to extend the weighted average unexpired lease term (WAULT) of the portfolio as well as diversifying the lease expiry profile. We have identified a higher level of lease expiries between 2020-2022 and 2027-2028. We are seeking purchases with expiries which will both extend the WAULT and diversify lease expiries.
- In addition to recommendations on industrial and retail purchases, we may also recommend alternative investments that offer good covenants, attractive yields and long unexpired terms; these may include hotels, car showrooms, healthcare, leisure and student housing.
- Set against a backdrop of mediocre economic growth, we will seek to make purchases where supply and demand conditions are stronger. This will ensure that purchases are accretive to the portfolio's performance.
- As we continually assess all of the properties within the portfolio, we will also consider sales based on asset specific considerations.
- The key driver of the portfolio performance will come from effective asset management of the existing stock to maximise rental income and extend lease lengths.
- A graph showing the expiry profile, per sector, is shown overleaf.

# PORTFOLIO STRATEGY AND FORECASTING

## Portfolio Strategy

Graph Showing Portfolio Lease Expiry Profile Per Sector

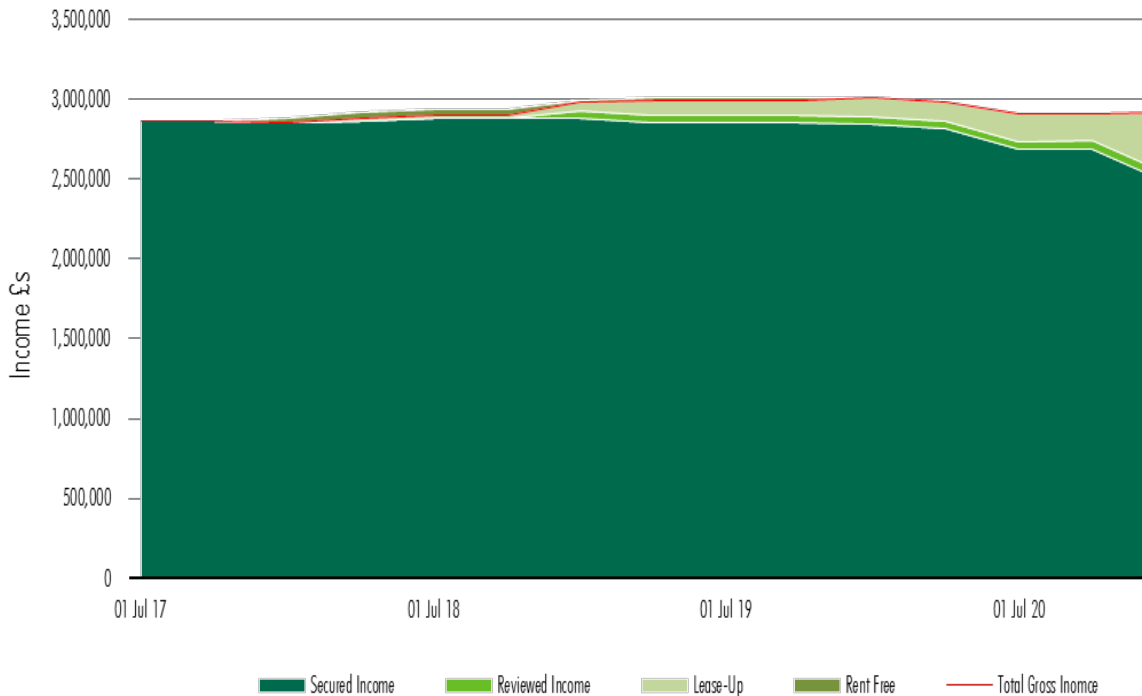




# PORTFOLIO POSITIONING AND FORECASTING

## Portfolio Analysis

### Portfolio Income Profile



The income forecast includes our current rental growth projections.

The CBRE forecasted rental growth figures have been taken as a starting point and have been adapted to more accurately reflect anticipated rental movement, based on the quality of individual assets and their estimated rental growth prospects.

REGION	% OF PORTFOLIO CAPITAL VALUE
London	13.8%
South East	13.9%
South West	6.2%
East	10.4%
West Midlands	31.6%
North East	13.7%
North West	7.7%
Scotland	2.6%
<b>Total</b>	<b>100%</b>

SECTOR	% of Portfolio (rental value)
Industrial	37.2%
Retail Warehouse	41.8%
High Street Retail	10.5%
Long Income	7.4%
Offices	3.2%
<b>Total</b>	<b>100%</b>



## TOP 20 TENANTS (BY CURRENT RENT)

TOP 20 TENANTS	TOTAL AREA	CURRENT RENT (£PA)	ERV (£PA)	% OF PORTFOLIO	NO. OF LEASES	FIRST LEASE EVENT
Libra Textiles	129,952	£920,000	£1,040,000	8.1%	1	04 April 2041
DHL Supply Chain Ltd.	146,138	£868,635	£875,000	7.7%	1	28 September 2021
Brunel Healthcare	136,342	£751,223	£650,000	6.6%	1	10 April 2028
P&O Ferrymasters Limited	122,157	£662,000	£685,000	5.9%	1	25 December 2020
Tesco Stores Limited	25,084	£640,554	£570,000	5.7%	1	28 July 2034
Matalan Retail Limited	51,753	£500,000	£500,000	4.4%	1	27 November 2028
HSBC Bank Plc	2,016	£440,000	£460,000	3.9%	1	18 October 2021
DSG Retail Limited (t/a Currys/PC World)	25,000	£375,000	£375,000	3.3%	1	28 September 2022
B&M Retail Limited (t/a B&M Homestore)	25,000	£375,000	£375,000	3.3%	1	28 September 2022
Nuffield Health	26,458	£354,715	£331,000	3.1%	1	04 April 2039
Homebase Ltd	25,000	£343,750	£362,300	3.0%	1	16 October 2027
Pets at Home Ltd	15,577	£325,825	£325,500	2.9%	2	05 January 2024
Institute of Cancer Research	9,502	£325,000	£370,000	2.9%	1	17 February 2018
Aurum Group Limited	1,440	£305,000	£305,000	2.7%	1	01 March 2031
Bonhams 1793 Ltd	38,722	£300,000	£465,000	2.7%	1	22 December 2028
River Island Clothing Co Ltd	1,270	£275,000	£280,000	2.4%	1	30 November 2028
B&Q plc	30,210	£252,000	£280,000	2.2%	1	31 January 2027
Speedy Assets Ltd.	20,492	£245,000	£255,000	2.2%	1	10 April 2021
Halfords Ltd	11,547	£242,295	£221,000	2.1%	3	23 June 2020
Saint Gobain Building Distribution Ltd	40,502	£236,151	£232,750	2.1%	2	14 November 2022
<b>TOTAL</b>	<b>884,162</b>	<b>£8,737,148</b>	<b>£8,957,550</b>	<b>77.2%</b>	<b>24</b>	

# 4 PORTFOLIO ACTIVITY



# PORTFOLIO ACTIVITY

## ASSET MANAGEMENT/TRANSACTION COMMENTARY



### Gateshead

- The Fund have recently completed the purchase of the Royal Mail Distribution Warehouse in Team Valley, Gateshead. The Fund purchased the property at 5.22% NIY, 5.78% EY, which equates to £16,150,000 net purchase price.

### Park Royal (Minerva Road)

- Rent review negotiations have resulted in an uplift and the new terms have been signed and documented.



### Lutterworth (Magna Park)

- Rent review negotiations have completed, resulting in an uplift. The new terms are being documented.

### Cirencester

- 99p Stores, trading as Poundland, have closed their unit by placing the company into Administration. The process of securing a replacement tenant is ongoing.



For more information regarding this presentation please contact:

**ANDREW OWEN OR ANTHONY MARTIN**

*Directors*

T +44(0) 20 7182 2474 OR

T +44(0) 20 7182 2466

[andrew.owen@cbre.com](mailto:andrew.owen@cbre.com) or [anthony.martin@cbre.com](mailto:anthony.martin@cbre.com)

**CBRE**