

**CBRE**

# **TEESSIDE PENSION FUND**

## **Quarterly Portfolio Strategy Report**

**25<sup>TH</sup> JANUARY 2018 – 8<sup>TH</sup> MAY 2018**

PREPARED FOR





# 1 EXECUTIVE SUMMARY

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# EXECUTIVE SUMMARY

## Portfolio Profile

### Current portfolio

- At 31st March 2018 the portfolio comprised 27 mixed-use properties located throughout the UK with a value of £262.69m. This reflects an overall Net Initial Yield of 5.37%, and an Equivalent Yield of 5.61%.
- The portfolio comprises principally prime and good secondary assets. High Street retail, retail warehouse and industrial comprise 83.3% of the portfolio by capital value. There are 64 demises and a total net lettable area of 1,875,721 sq ft.
- The weighted average unexpired term is 9.2 years to the earlier of first break or expiry, and 10.6 years to expiry, ignoring break dates.
- The portfolio also has the following characteristics:
  - The vacancy rate is currently 0.86% of Estimated Rental Value. The 'IPD Quarterly Index Q4 2017' confirmed an average void rate of 6.99% by ERV
  - The top ten tenants constitute 54.6% of the total gross annual income of the portfolio, while the top twenty tenants constitute 77.4%.
  - Current gross passing rent is £15,036,568 per annum, against a gross current market rent of £15,487,588 per annum.



# EXECUTIVE SUMMARY

## Portfolio Activity And Strategy

### Portfolio arrears at 8<sup>th</sup> May 2018

The total Collectable Arrears on the entire portfolio is £36,627.13 at 8<sup>th</sup> May 2018. The Collectable Arrears exclude the following:

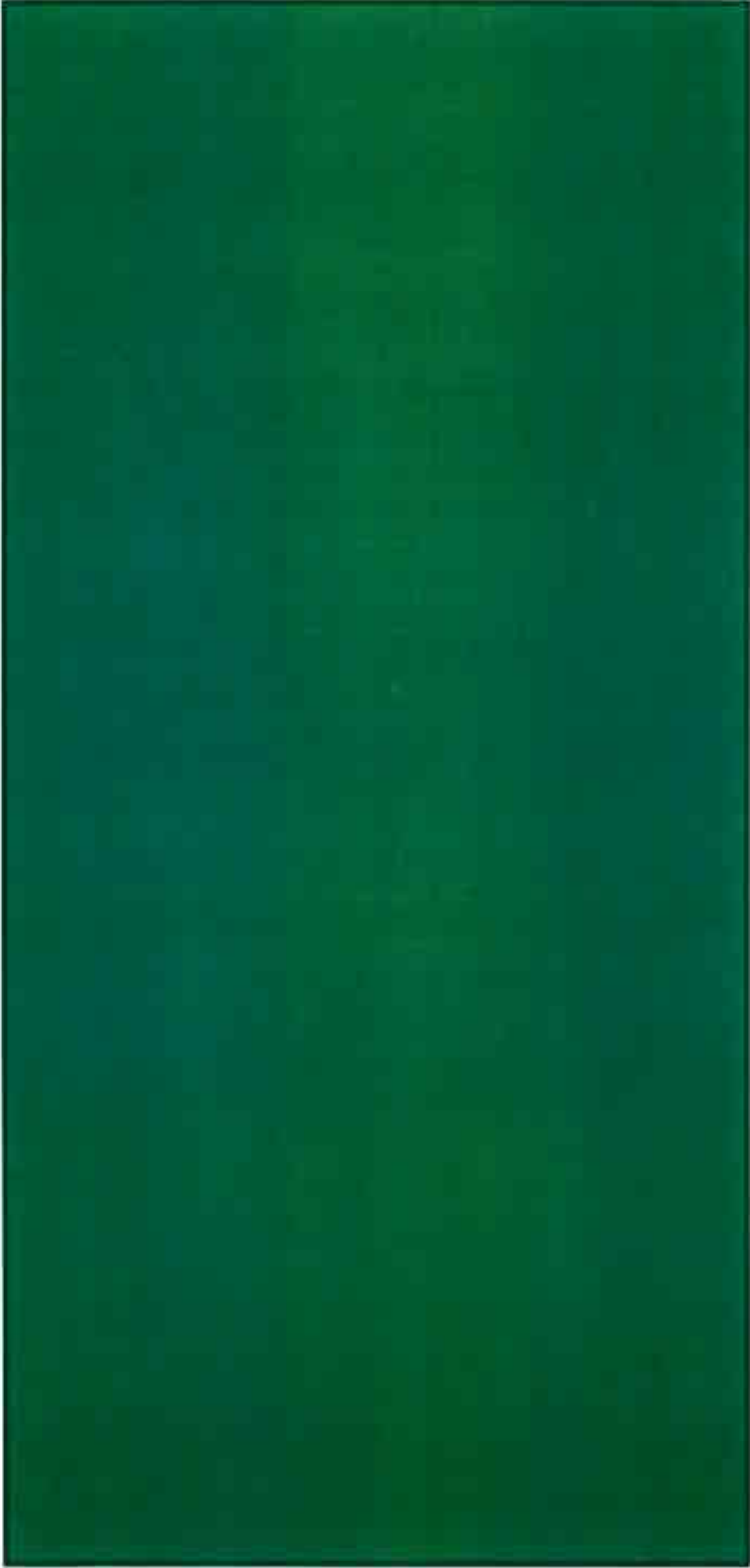
- Tenants that pay their quarterly rent in monthly instalments and are up-to-date with payments (Aurum Group Ltd and J.F. Stone Investments Ltd).
- Tenants that are insolvent (99p Stores Limited at Cirencester and Multiyork Furniture Limited at Ipswich)
- Tenants with new charges that have been raised within the last month.
- Tenants that have overall credit balances on their accounts.

Of the Collectable Arrears, 65.9% (£24,136.71) relates to a single property:

**Westway Retail Park, Ayrtoath** – There is service charge arrears from three tenants at this property. This is due to the service charge structure being redrafted in order to make it more transparent than the previous historic version. We are liaising with the tenants and their service charge consultants to agree the new structure, then the clearing of these arrears.

- B&Q - £16,726.96
- Pets at Home - £3,901.74
- Halfords - £3,508.01

The remaining 34.1% of the Collectable Arrears (£12,490.42) relate to 10 different tenant accounts, all of which are being chased.



## 2 ECONOMIC PERFORMANCE AND PROPERTY MARKET

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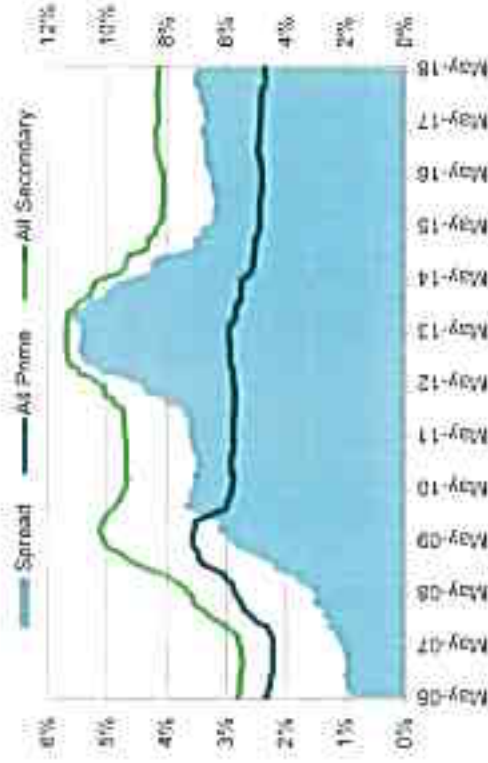


# PROPERTY MARKET & SECTOR FORECASTS

## Property Market Q1 2018

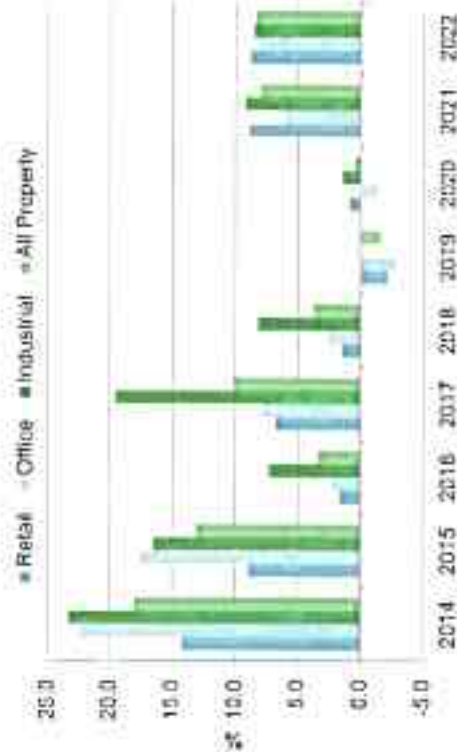
- Total Returns for All UK Property were 11.3% for the period Q1 2017 to Q1 2018\*. Capital values for Q3 recorded a 0.9% increase over the quarter.
- Industrials again recorded a strong performance compared with other sectors in Q1 2018. Total return and capital value growth were 4.4% and 3.1% for the quarter, respectively.
- Rental values increased by 0.5% in the first quarter of 2018 – which mirrors rental growth for the same period in the preceding year. The highest rental value growth in Q1 was recorded for Industrials at 1.3%.

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



Source: CBRE Monthly Yields, May 2018

Property Total Returns



Source: IFO, CBRE, Mar 2018

\* Based on CBRE Monthly Index, all property total returns March 2018



# PROPERTY MARKET AND SECTOR FORECASTS

## UK Returns Forecast Q1 2018

	2016	2017	2018	Forecast*			Annualised 2018-2022
				2019	2020	2021	
	<b>Total return: % per year</b>						
Retail	1.7	6.9	1.5	-2.1	0.9	9.0	8.9
Office	2.3	7.9	2.6	-2.9	-1.4	6.1	8.2
Industrial	7.3	19.6	8.2	0.0	1.4	9.3	8.6
All Property	3.5	10.2	3.7	-1.6	0.5	8.1	8.4

<b>Income return: % per year</b>							
Retail	5.2	5.1	5.1	5.3	5.6	5.5	5.3
Office	4.1	4.1	4.1	4.2	4.5	4.5	4.3
Industrial	5.3	5.1	4.7	4.8	5.2	5.2	4.9
All Property	4.9	4.8	4.6	4.7	4.9	4.9	4.7

<b>Capital growth: % per year</b>							
Retail	-3.3	1.7	-3.4	-7.1	-4.4	3.3	3.4
Office	-1.7	3.6	-1.5	-6.9	-5.6	1.5	3.7
Industrial	2.0	13.9	3.4	-4.6	-3.5	3.9	3.5
All Property	-1.3	5.2	-0.8	-6.0	-4.2	3.0	3.5

<b>Nominal rental value growth: % per year</b>							
Retail	1.0	1.1	0.0	-0.3	-0.6	-0.3	0.7
Office	2.9	1.5	-0.5	-1.6	-2.2	-1.1	1.0
Industrial	3.5	5.3	4.4	3.2	1.4	-0.1	-0.2
All Property	2.1	2.2	0.9	0.2	-0.5	-0.3	0.7

<b>Equivalent Yields: % at end year</b>							
Retail	5.7	5.5	5.8	6.1	6.3	6.0	5.8
Office	6.0	5.8	5.8	6.1	6.2	6.0	5.7
Industrial	6.3	5.7	5.7	6.1	6.3	6.0	5.7
All Property	5.9	5.6	5.6	5.9	6.1	5.8	5.6

\* Forecast figures based on Q1 2018 quarterly valuations

Source: CBRE, Q1 2018

We expect mixed performance across sectors over the foreseeable future. This is the result of different demand and supply interplay within sectors, against a backdrop of uncertainty concerning Brexit, economic growth and rising interest rates.

All property total returns registered 10.2% in 2017. Returns were positive for all sectors, and received support from strong rental growth. Our forecast for 2018 currently sits at 3.7%, with the Industrial sector being the significant driver of this performance. Total returns in 2019 are expected to be slightly negative overall, as yields rise across all sectors. As values fall, total returns will be driven by income return. From 2020, these will start to recover, with annualised all property total returns averaging 3.8% over the five years.

Rental growth falls are forecast in the Office sector while Industrial rents continue to grow, albeit at a slower pace, and Retail rents remain slightly positive. The general movement in rents highlights our outlook for the UK economy, with market factors such as weak retail spending, slowing employment growth and rising e-commerce giving sectoral variation.



Message attached to this

# PORTFOLIO STRATEGY AND FORECASTING

## Portfolio Strategy

### TOP DOWN STRATEGY

- The Teesside Pension Fund was valued at approximately £4.00bn (December 2017). The direct property portfolio held by the Fund was valued at £262.69m (March 2018). The Fund's real estate exposure (6.57% 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 high level of lease expiries between 2020 and 2022, as well as in 2028 and 2029. 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.

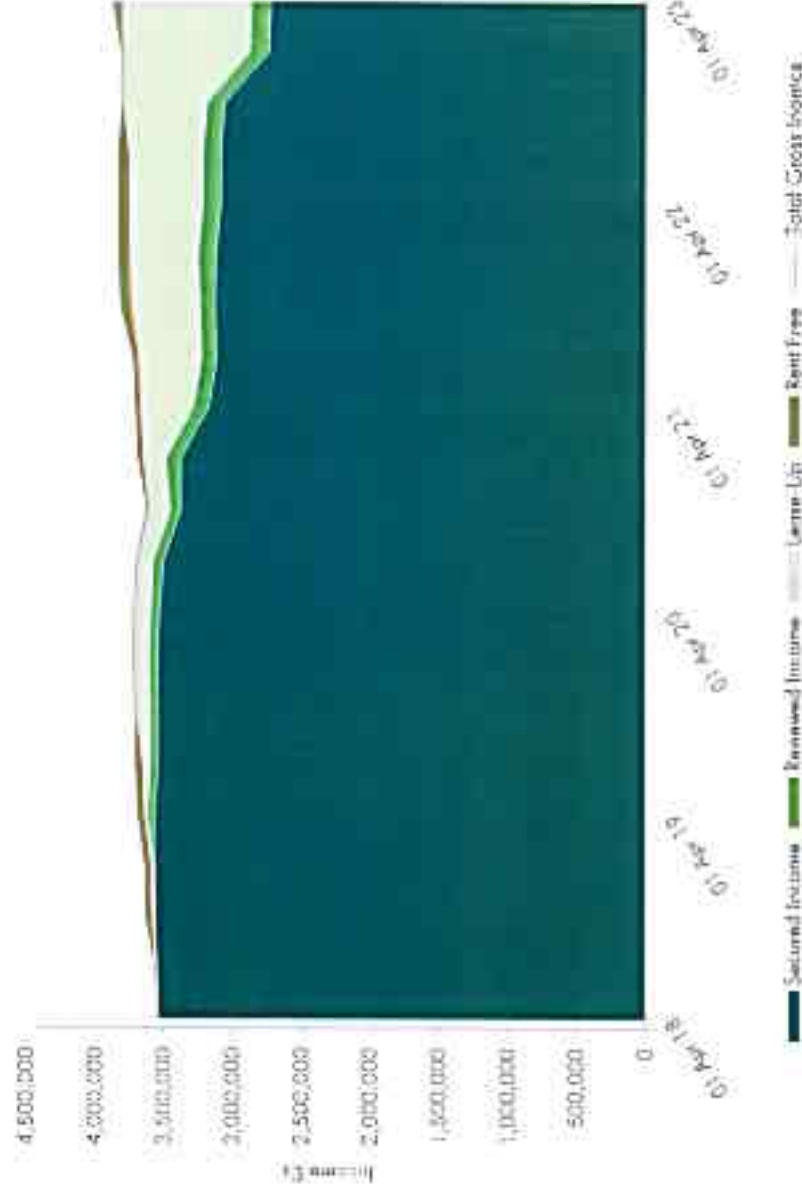




# PORTFOLIO POSITIONING AND FORECASTING

## 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	11.7%
South East	11.2%
South West	4.9%
East	8.3%
West Midlands	25.5%
North East	30.2%
North West	6.1%
Scotland	2.1%
Total	100%

SECTOR	% OF PORTFOLIO (RENTAL VALUE)
Industrial	45.6%
Retail Warehouse	31.0%
High Street Retail	8.3%
Long Income	12.5%
Offices	2.5%
Total	100%





## 4 PORTFOLIO ACTIVITY

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