

**CBRE**

# **TEESSIDE PENSION FUND**

## **Quarterly Portfolio Strategy Report**

**9<sup>TH</sup> MAY 2018 – 8<sup>TH</sup> AUGUST 2018**

PREPARED FOR





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# 1 EXECUTIVE SUMMARY

# EXECUTIVE SUMMARY

## Portfolio Strategy

You have advised us that your objective is to increase the property portfolio to £300m in a risk controlled manner.

### CBRE Recommended Strategy

- To diversify the portfolio through different property types, unit sizes, occupier businesses, quality, income expiry and geographical regions.
- To make acquisitions and disposals that help balance the portfolio's overall lease expiry profile.
- Seek a long term heavily weighted position in industrial and retail, alongside a lighter weight position in offices.
- Acquire prime, well let properties, together with some RPI linked assets.
- Keep the vacancy rate lower than typical institutional investment portfolio levels, whilst reducing income risk in particular years.

SECTOR	CURRENT WEIGHTING	TARGET WEIGHTING
Industrial	46.4%	40.2%
Retail Warehouse	27.4%	30.0%
Long Income	13.6%	18.5%
Offices	2.8%	2.5%
High Street Retail	9.8%	8.8%
	100%	100%

# EXECUTIVE SUMMARY

## Portfolio Profile

- At 30<sup>th</sup> June 2018 the portfolio comprised 27 mixed-use properties located throughout the UK, with a combined value of £266.71m. This reflects an overall Net Initial Yield of 5.36%, and an Equivalent Yield of 5.55%.
- The portfolio comprises principally prime and good secondary assets. High Street retail, retail warehouse and industrial comprise 83.6% 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 9.0 years to the earlier of first break or expiry, and 10.4 years to expiry, ignoring break dates.
- The portfolio also has the following characteristics:
  - The vacancy rate is currently 0.9% of Estimated Rental Value. The 'IRIS Digest Q1 2018' confirmed an 'all sectors' average void rate of 7.1% by ERV.
  - The top ten tenants constitute 54.6% of the total gross annual income of the portfolio, while the top twenty tenants constitute 77.1%.
  - Current gross passing rent is £15,213,753 per annum, against a gross current market rent of £15,559,318 per annum, making the portfolio reversionary in nature.

# EXECUTIVE SUMMARY

## Portfolio Activity

### Investments

### Sales

- There were no sales in Q2 2018.

### Acquisitions

- There were no acquisitions in Q2 2018.

# EXECUTIVE SUMMARY

## Portfolio Activity And Strategy

### Portfolio arrears at 11th July 2018

The total Collectable Arrears on the entire portfolio is £31,396.63 at 11 Jul 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, 77.9% (£24,461.64) relates to the following three tenants:**

- B&Q plc (Arbroath) - Total arrears of £16,726.96 (53.3% of the collectable arrears). This relates solely to service charge payment and is due to the service charge being restructured for the whole property.
- Halfords Ltd (Arbroath) - Total arrears of £4,018.92 (12.8% of the collectable arrears). This relates solely to service charge and is similar to the above scenario.
- Go Karting For Fun Limited (Nottingham) - Total arrears of £3,715.76 (11.8% of the collectable arrears). This relates to a short-payment of rent, following a recent stepped rent increase.

The remaining 22.1% of the Collectable Arrears (£6,934.99) relate to 13 different tenant accounts; all of which are being chased.

# EXECUTIVE SUMMARY

## Rent Collection Statistics

Debtor Name	Rent Due 24 June	Collectable Rent	Targets	92.00%	96.00%	98.00%	99.00%	Payment after 22/07/2018	Difference
			Quarter Date up to and including 24/06/2018	Week 1 up to and including 01/07/2018	Week 2 up to and including 08/07/2018	Week 3 up to and including 15/07/2018	Week 4 up to and including 22/07/2018		
	3,836,461.99	3,730,106.99	3,498,549.49	81,246.50	134,052.50	0.00	12,008.50	0.00	4,250.00
Non Collectable Total		106,355.00							
Collections Including non collectables			91.19%	93.31%	96.80%	96.80%	97.12%	0.97	
Collections Excluding non collectables			93.79%	95.97%	99.56%	99.56%	99.89%	1.00	

These figures relate to rents that only became due on the June English Quarter Day (24<sup>th</sup> June 2018).

The non-collectable sum (£4,250) relates to J F Stone Investments Ltd at 17-23, Gloucester Road – who currently pay rent on a monthly basis.

The rent attributed to the unit formerly occupied by Multiyork at Interchange Retail Park is being paid by a guarantor to the lease. Multiyork entered administration on 22<sup>nd</sup> November 2017.

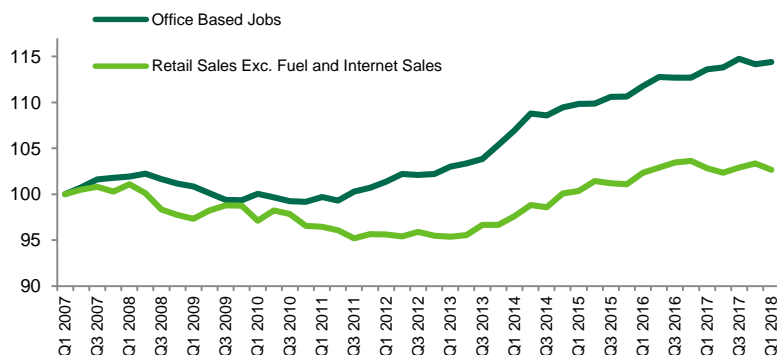
## 2 ECONOMIC PERFORMANCE AND PROPERTY MARKET

# PROPERTY MARKET & SECTOR FORECASTS

## Economic Performance Q2 2018

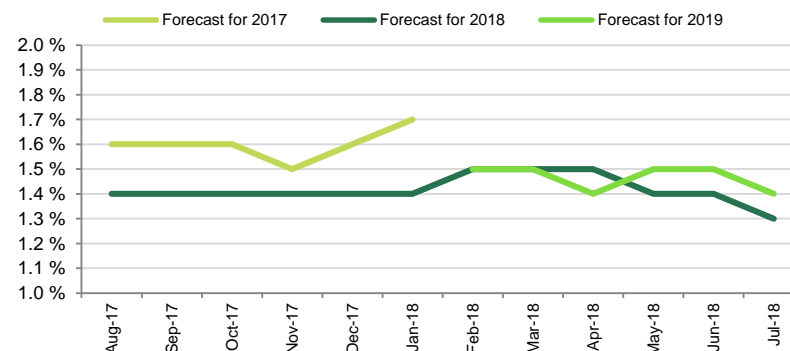
- Growth seems to have picked up since a weak Q1, but challenges remain. Domestically, uncertainty around Brexit continues to have a negative impact on business sentiment and investment, although employment remains at an all-time high. At the same time, consumers are enjoying a small recovery in their real earnings. Earnings growth remains modest but inflation has so far defied expectations and failed to accelerate in the face of surging oil prices.
- Labour market performance remains positive on the whole. The unemployment rate, 4.2% in the three months to May, has not been lower since 1975 and continues to edge downwards. This is expected to exert some upward pressure on wages as labour shortages become more acute.
- A recovery in retail sales over April and May led to the strongest quarter-on-quarter growth in volumes since Q1 2004, with 2.9% growth on last year (excluding fuel). Despite strong sales in drinks and big-screen TVs resulting from the World Cup, declining overall sales in June have highlighted that the retail environment remains challenging. Given an already low savings rate and reliance on credit card debt, consumer spending will remain under pressure until inflation falls.

**Economic Drivers of Commercial Property Demand**



Source: CBRE, Oxford Economics, ONS

**Evolution of UK GDP Jan-Dec Growth Forecasts**



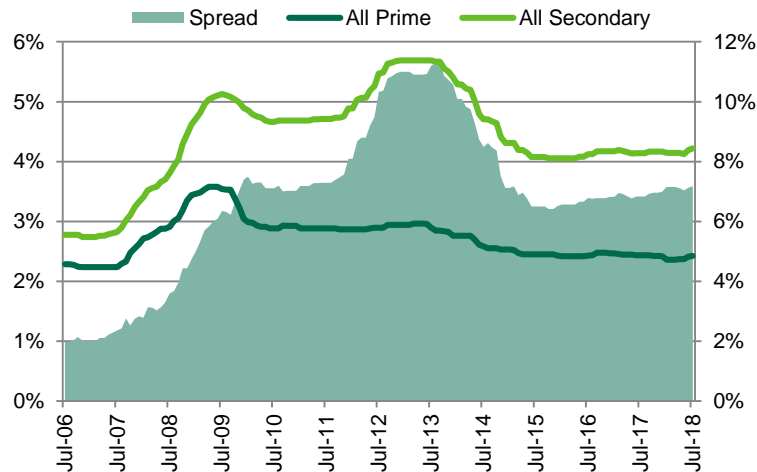
Source: HM Treasury Consensus

# PROPERTY MARKET & SECTOR FORECASTS

## Property Market Q2 2018

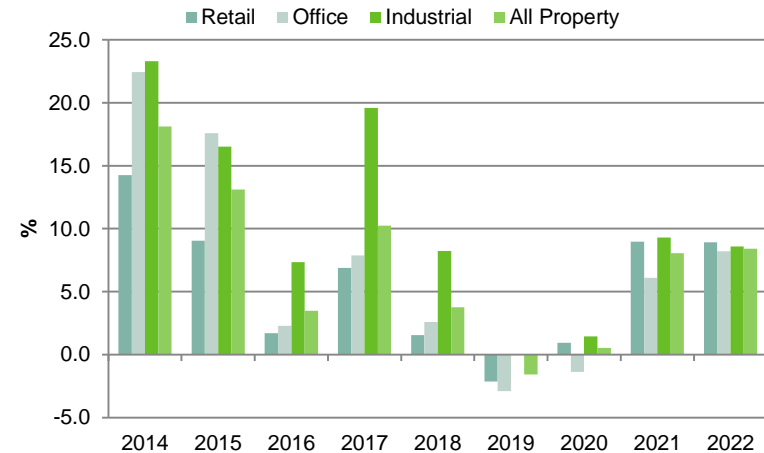
- Year on year total returns for All UK Property were 10.5% (4.8%\* capital return, 5.5%\* income return) for the period Q2 2017 to Q2 2018\*\*. Year on year returns at this level are marginally lower than the 5 year average.
- Quarterly total returns for All UK Property for Q2 recorded 1.9% (0.6% capital return, 1.3% income return).
- Industrials again recorded a strong performance compared with other sectors in Q2 2018. Total returns in this sector were recorded at 5.0% (3.7% capital return, 1.3% income return), with capital value growth being notably above the 5 year quarterly average.
- Rental values for All UK Property increased by 0.2% in the second quarter of 2018. This figure was largely driven by growth in the industrial sector, recorded at 1.1% for the quarter. Conversely the retail sector hampered overall rental growth figures, having recorded -0.5% growth for the quarter.

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



Source: CBRE Monthly Yields, July 2018

Property Total Returns



Source: IPD, CBRE, May 2018

\* Return figures will not always sum due to separate compound calculations

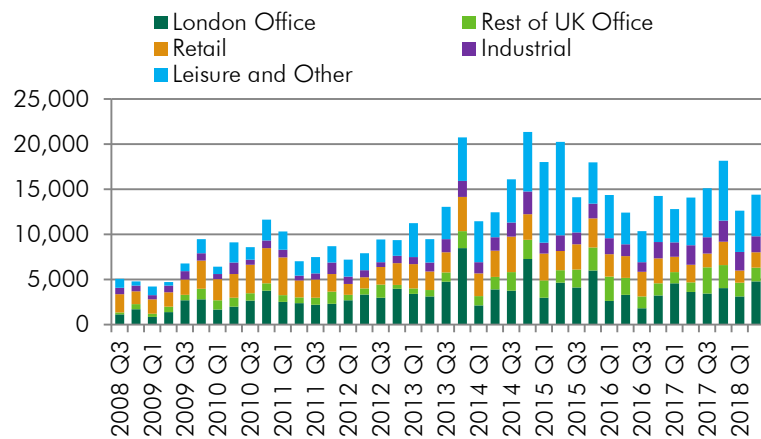
CBRE \*\* Based on CBRE Monthly Index, all property total returns June 2018

# PROPERTY MARKET & SECTOR FORECASTS

## Property Market Q2 2018 Transactions

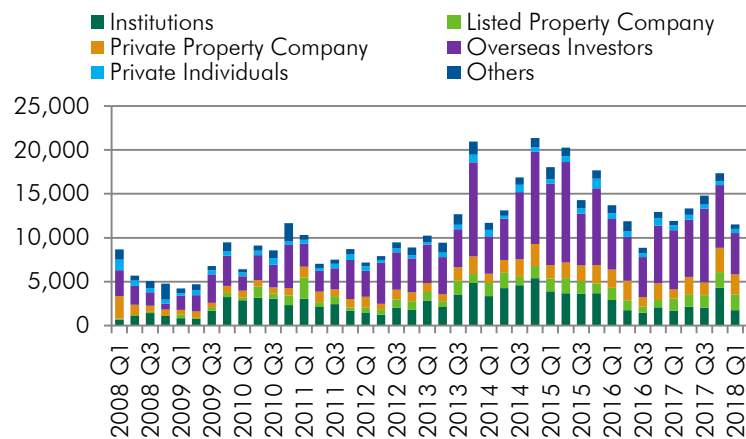
- In Q2 2018, investors recorded a total transaction value for 'All Property' of £14.4bn. This is an improvement on the £12.6bn reported in Q1, which was the lowest transaction volume of any quarter since Q3 2016.
- In Q2, 46% of investors were overseas investors, holding firm from Q4 2017. The continuation of overseas investor interest has likely been driven in part by the devaluation of Sterling following the 'Brexit' vote. UK institutions accounted for 22% of transactions in Q2 2018, which amounts to c. £3.0bn of investment. This is significantly up on the 15% reported last quarter.
- Investment transactions for 'All Offices' totalled £6.3bn in Q2 2018. Central London office investment recorded £4.8bn in investment, accounting for 76% of total office investment for the quarter. The highest investment during this quarter was the purchase of 5 Broadgate in London for £1.0bn.
- The Industrial sector saw £1.8bn in transaction activity in Q2 2018, reflecting the continued interest in this sector. The biggest deal of Q2 was Westbrook Partners' purchase of an industrial portfolio for £162m.
- Retail transactions totalled £1.7bn for the quarter, with Motcomb Estates purchasing Burlington Arcade for £296.5m.

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



Source: : CBRE, Property Data, July 2018

CBRE



Source: CBRE, Property Data, July 2018

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teesside pension fund

# PROPERTY MARKET & SECTOR FORECASTS

## UK Returns Forecast

	2016	2017	Forecast*					Annualised
			2018	2019	2020	2021	2022	2018-2022
<b>Total return: % per year</b>								
Retail	1.7	6.9	1.5	-2.1	0.9	9.0	8.9	3.5
Office	2.3	7.9	2.6	-2.9	-1.4	6.1	8.2	2.4
Industrial	7.3	19.6	8.2	0.0	1.4	9.3	8.6	5.4
All Property	3.5	10.2	3.7	-1.6	0.5	8.1	8.4	3.8
<b>Income return: % per year</b>								
Retail	5.2	5.1	5.1	5.3	5.6	5.5	5.3	5.4
Office	4.1	4.1	4.1	4.2	4.5	4.5	4.3	4.3
Industrial	5.3	5.1	4.7	4.8	5.2	5.2	4.9	4.9
All Property	4.9	4.8	4.6	4.7	4.9	4.9	4.7	4.8
<b>Capital growth: % per year</b>								
Retail	-3.3	1.7	-3.4	-7.1	-4.4	3.3	3.4	-1.7
Office	-1.7	3.6	-1.5	-6.9	-5.6	1.5	3.7	-1.8
Industrial	2.0	13.9	3.4	-4.6	-3.5	3.9	3.5	0.5
All Property	-1.3	5.2	-0.8	-6.0	-4.2	3.0	3.5	-1.0
<b>Nominal rental value growth: % per year</b>								
Retail	1.0	1.1	0.0	-0.3	-0.6	-0.3	0.7	-0.1
Office	2.9	1.5	-0.5	-1.6	-2.2	-1.1	1.0	-0.9
Industrial	3.5	5.3	4.4	3.2	1.4	-0.1	-0.2	1.7
All Property	2.1	2.2	0.9	0.2	-0.5	-0.3	0.7	0.2
<b>Equivalent Yields: % at end year</b>								
								<b>Change pp</b>
Retail	5.7	5.5	5.8	6.1	6.3	6.0	5.8	0.3
Office	6.0	5.8	5.8	6.1	6.2	6.0	5.7	-0.1
Industrial	6.3	5.7	5.7	6.1	6.3	6.0	5.7	0.1
All Property	5.9	5.6	5.6	5.9	6.1	5.8	5.6	0.0

\* Forecast figures issued May 2018

Source: CBRE

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 UK 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 than before, and Retail rents remain slightly positive. The general movement in rents is largely predicated on our outlook for the UK economy, with due consideration to key market factors such as weak retail spending, slowing employment growth and the continued rise of e-commerce.





# 3 PORTFOLIO STRATEGY AND FORECASTING

# PORTFOLIO STRATEGY AND FORECASTING

## Portfolio Strategy

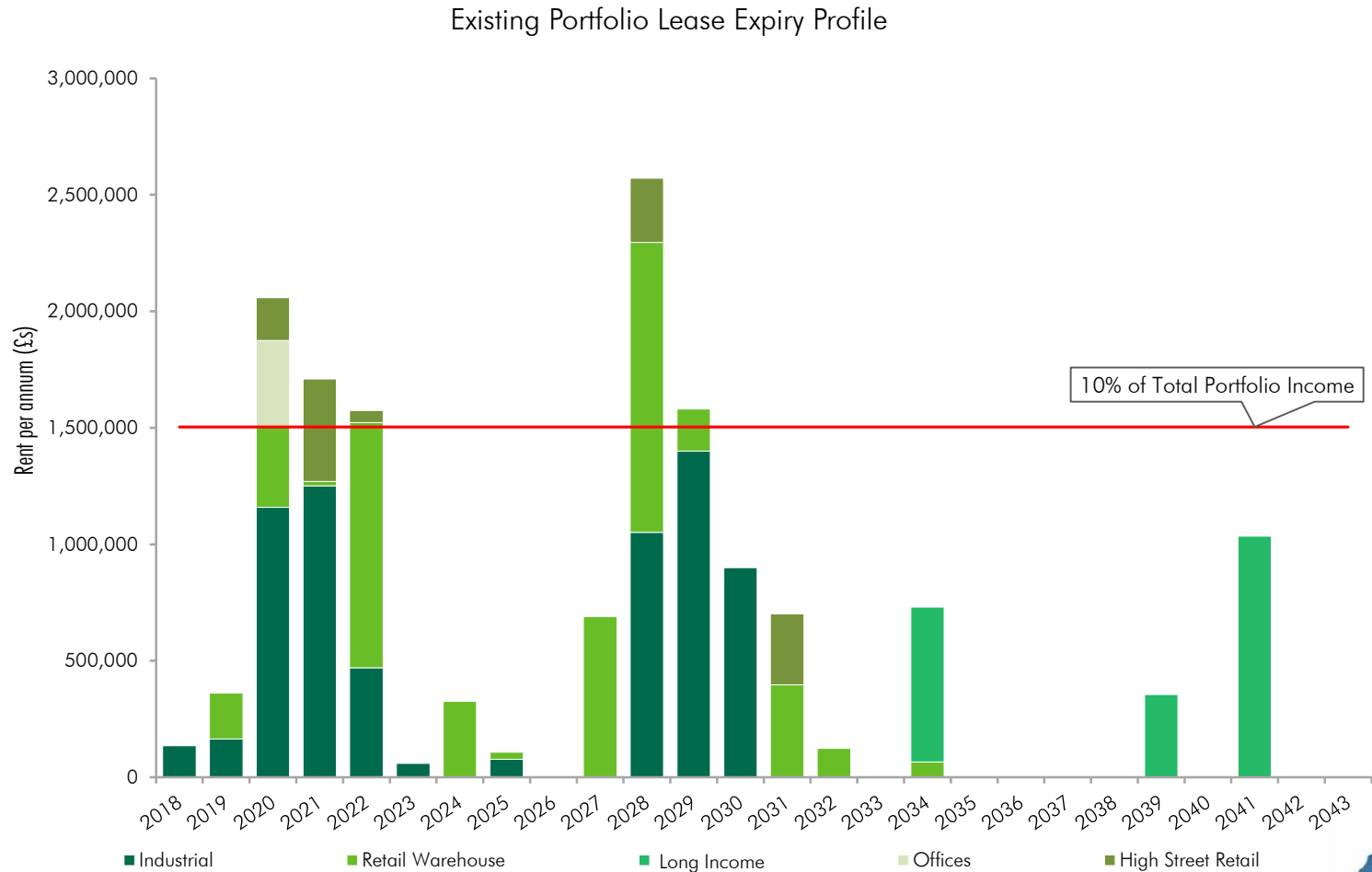
### Top Down Strategy

- The Teesside Pension Fund was valued at approximately £4.1bn (May 2018). The direct property portfolio held by the Fund was valued at £266.71m (June 2018), equating to 6.5% of overall Fund value. The Fund's level of real estate exposure is generally considered 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. There are a high level of lease expiries between 2020 and 2022, as well as in 2028 and 2029.
- 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 both occupational and investment supply and demand conditions are strong. 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.
- A key driver of the portfolio performance will continue to 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

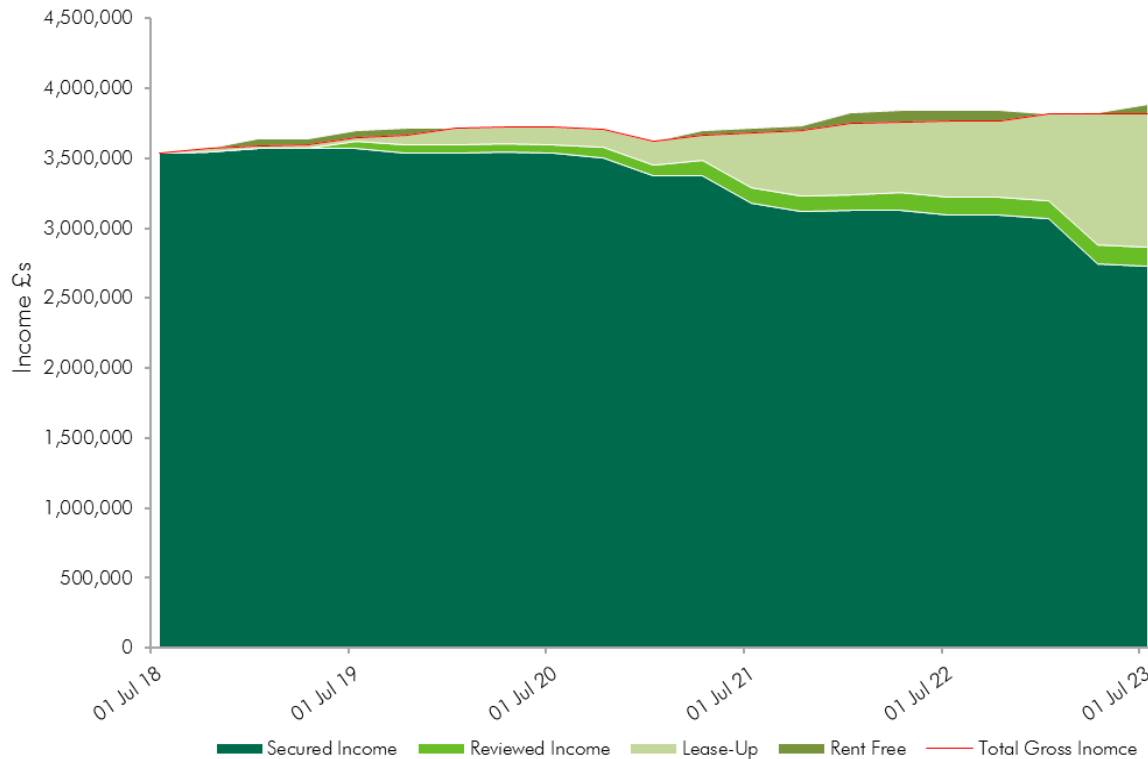
### Expiry Risk



# PORTFOLIO POSITIONING AND FORECASTING

## Portfolio Analysis

### Portfolio Income Profile



The income forecast includes our current rental growth projections.

CBRE forecasted rental growth figures have been used and adapted to reflect anticipated rental movement, based on the quality and sub-location of individual assets.

REGION	% OF PORTFOLIO CAPITAL VALUE
London	12.7%
South East	10.9%
South West	4.6%
East	8.1%
West Midlands	25.6%
North East	30.1%
North West	6.0%
Scotland	2.0%
<b>Total</b>	<b>100%</b>

SECTOR	% OF PORTFOLIO (RENTAL VALUE)
Industrial	45.0%
Retail Warehouse	30.7%
High Street Retail	8.2%
Long Income	13.5%
Offices	2.6%
<b>Total</b>	<b>100%</b>

## TOP 20 TENANTS (BY CURRENT RENT)

POSITION	TOP 20 TENANTS	TOTAL AREA	CURRENT RENT (£PA)	ERV (£PA)	% OF PORTFOLIO	NO. OF LEASES	FIRST LEASE EVENT
1	Omega Plc	320,815	£1,400,000	£1,400,000	9.20%	1	09 September 2029
2	Libra Textiles	129,952	£1,035,000	£1,040,000	6.80%	1	04 April 2041
3	B&Q plc	101,714	£997,000	£1,025,000	6.55%	2	31 January 2027
4	Royal Mail Group Limited	207,572	£899,161	£1,000,000	5.91%	1	23 September 2030
5	DHL Supply Chain Ltd.	146,138	£868,635	£875,000	5.71%	1	28 September 2021
6	Brunel Healthcare	136,342	£844,368	£650,000	5.55%	1	10 April 2028
7	Tesco Stores Limited	25,084	£664,016	£570,000	4.36%	1	28 July 2034
8	P&O Ferrymasters Limited	122,157	£662,000	£685,000	4.35%	1	25 December 2020
9	Matalan Retail Limited	51,753	£500,000	£500,000	3.29%	1	27 November 2028
10	HSBC Bank Plc	2,016	£440,000	£460,000	2.89%	1	18 October 2021
11	Wickes Building Supplies Limited	28,338	£396,750	£396,750	2.61%	1	28 September 2031
12	DSG Retail Limited (t/a Currys/PC World)	25,000	£375,000	£375,000	2.46%	1	28 September 2022
13	B&M Retail Limited (t/a B&M Homestore)	25,000	£375,000	£375,000	2.46%	1	28 September 2022
14	Institute of Cancer Research	9,502	£371,420	£371,420	2.44%	1	17 February 2020
15	Nuffield Health	26,458	£354,715	£331,000	2.33%	1	04 April 2039
16	Homebase Ltd	25,000	£343,750	£343,750	2.26%	1	16 October 2027
17	Pets at Home Ltd	15,577	£325,825	£325,500	2.14%	2	05 January 2024
18	Aurum Group Limited	1,440	£305,000	£305,000	2.00%	1	01 March 2031
19	Bonhams 1793 Ltd	38,722	£300,000	£525,000	1.97%	1	22 December 2028
20	River Island Clothing Co Ltd	1,270	£275,000	£280,000	1.81%	1	30 November 2028
<b>TOTAL</b>	<b>-</b>	<b>1,439,850</b>	<b>£11,732,640</b>	<b>£11,833,420</b>	<b>77.1%</b>	<b>22</b>	<b>-</b>



## 4 PORTFOLIO ACTIVITY

# PORTFOLIO ACTIVITY

## ASSET MANAGEMENT COMMENTARY



### Cirencester Retail Park

- Following its fall into Administration, 99p Stores vacated its unit on the Park. ESH have been engaged to re-let the unit and have advised of increased occupier interest on a split unit basis. Unit subdivision is therefore being pursued with planning advice being sought from the CBRE planning team.



### Bromford Central, Birmingham

- A number of rent reviews and renewal discussions are live on this multi-let industrial estate. CBRE Lease consultancy have been engaged to carry out negotiations. Uplifts in rent have been achieved at review on both unit 3 and unit 6 and negotiations regarding three of the other units are nearing completion.



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