

**CBRE**

# **TEESSIDE PENSION FUND**

## **Quarterly Portfolio Strategy Report**

**1<sup>ST</sup> SEPTEMBER 2018 – 31<sup>ST</sup> DECEMBER 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 £350m 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 an under 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	41.0%	40.2%
Retail Warehouse	28.1%	30.0%
Long Income	2.2%	18.5%
Offices	2.5%	2.5%
High Street Retail	16.2%	8.8%
	100%	100%

# EXECUTIVE SUMMARY

## Portfolio Profile

- At 31<sup>st</sup> December 2018 the portfolio comprised 28 mixed-use properties located throughout the UK, with a combined value of £303.95m. This reflects an overall Net Initial Yield of 5.24%, and an Equivalent Yield of 5.48%.
- The portfolio comprises principally prime and good secondary assets. High Street retail, retail warehouse and industrial comprise 85.4% of the portfolio by capital value. There are 75 demises and a total net lettable area of 1,949,442 sq ft.
- The weighted average unexpired term is 8.0 years to the earlier of first break or expiry, and 9.8 years to expiry, ignoring break dates.
- The portfolio also has the following characteristics:
  - The vacancy rate is currently 1.3% of Estimated Rental Value. By comparison, the 'IRIS Digest Q3 2018' confirmed an 'all sectors' average void rate of 7.4% by ERV.
  - The top ten tenants constitute 51.4% of the total gross annual income of the portfolio, while the top twenty tenants constitute 73.5%.
  - Current gross passing rent is £16,738,388 per annum, against a gross current market rent of £17,558,518 per annum, making the portfolio reversionary in nature.

# EXECUTIVE SUMMARY

## Portfolio Activity

### Investments

#### Sales

- The Fund successfully disposed of the industrial asset at Pintail Close in Nottingham, occupied by Go Karting For Fun Ltd, to the St John's High Income Property Fund for £2,450,000. This sale price was £165,000 ahead of the asking price and £150,000 (+12.6%) ahead of the Capital Value as at the September 2018 valuation. The sale completed in December 2018.

#### Acquisitions

- The Fund acquired Congleton Retail Park in Q3 2018. The Fund purchased the property for 6.50% NIY, equating to a net purchase price of £15.1m.
- The Fund also completed the purchase of 16/20 High Street & 3 Bedford Street, Exeter. The property was acquired for £23.50m – reflecting a 4.74% NIY. The Tenants are H&M and Barclays Bank. This acquisition completed in October 2018 and was included in the December 2018 valuation.

# EXECUTIVE SUMMARY

## Portfolio Activity And Strategy

### Portfolio arrears at 17<sup>th</sup> January 2019

The total Collectable Arrears on the entire portfolio is £111,215.89 at 17<sup>th</sup> January 2019. The Collectable Arrears exclude the following:

- Tenants that are insolvent (99p Stores Limited at Cirencester).
- Tenants that are charged quarterly but pay monthly and are up to date (B&Q Plc at Hull, Aurum Group Limited at Newcastle and J.F. Stone Investments Limited at Gloucester Road).
- 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, 94.6% (£105,243.04) relates to the following three tenants:

- **Fine Art Group Holdings Limited (Sovereign Park, London)** – Total arrears of £90,000 (80.9% of the collectable arrears). This relates solely to the December quarter's rent. This has been delayed due to the lease being assigned from Bonham's 1793 Limited.
- **B&Q Plc (Arbroath)** – Total arrears of £10,471.06 (9.4% of the collectable arrears). This relates solely to two service charge payments from 28/11/2017 and 28/02/2018 and is due to the service charge being restructured for the whole property. All other sums have been paid in full. The Surveyor has been working closely with the tenant and their agent (Profile Consultancy) and whilst most issues raised have been resolved, the main issue outstanding relates to their floor area and how this differs from the lease to the apportionment in the service charge. Discussions are continuing.
- **Halfords Limited (Arbroath)** – Total arrears of £4,771.98 (4.3% of the collectable arrears). This relates solely to a back dated rent charge following the settlement of the 2017 rent review. The charge was raised in October 2018 and we are continuing to chase for payment. All other sums have been paid in full.

The remaining 5.40% of the Collectable Arrears (£5,972.85) relate to 17 different tenant accounts; all of which are being chased.

# EXECUTIVE SUMMARY

## Rent Collection Statistics

### Rent Collection Statistics at 25<sup>th</sup> December 2018

Debtor Name	Rent Due 25 December	Collectable Rent	Targets	92.00%	96.00%	98.00%	99.00%	Payment after 22/01/2019	Difference
			Quarter Date up to and including 25/12/2018	Week 1 up to and including 01/01/2019	Week 2 up to and including 08/01/2019	Week 3 up to and including 15/01/2019	Week 4 up to and including 22/01/2019		
Non Collectable Total	4,521,244.21	4,302,744.21	3,564,108.31	188,601.40	221,776.00	226,250.00	0.00	12,008.50	90,000.00
Collections Including non collectables		218,500.00							
Collections Excluding non collectables			78.83%	83.00%	87.91%	92.91%	92.91%	93.18%	
			82.83%	87.22%	92.37%	97.63%	97.63%	97.91%	

These figures relate to rents that only became due on the December English Quarter Day (25<sup>th</sup> December 2018).

The total non-collectable sum equates to £218,500. This relates to; B&Q Plc, Hull (£149,000), Aurum Group Ltd (£61,000) and J.F. Stone Investments Ltd (£8,500). All tenants are either being chased or have paid, with payment receipt pending bank transfer completion.

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.



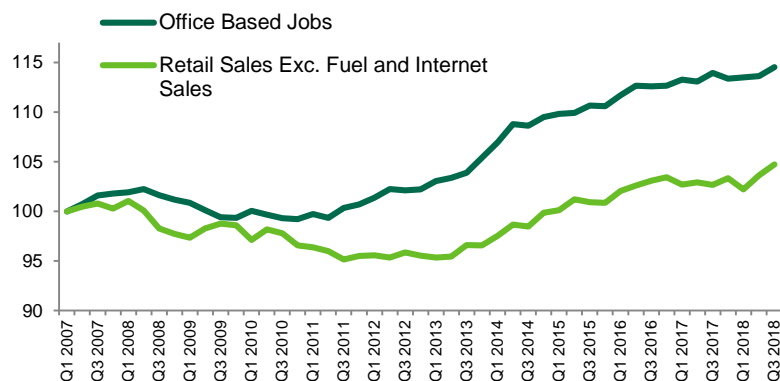
## 2 ECONOMIC PERFORMANCE AND PROPERTY MARKET

# PROPERTY MARKET & SECTOR FORECASTS

## Economic Performance Q4 2018

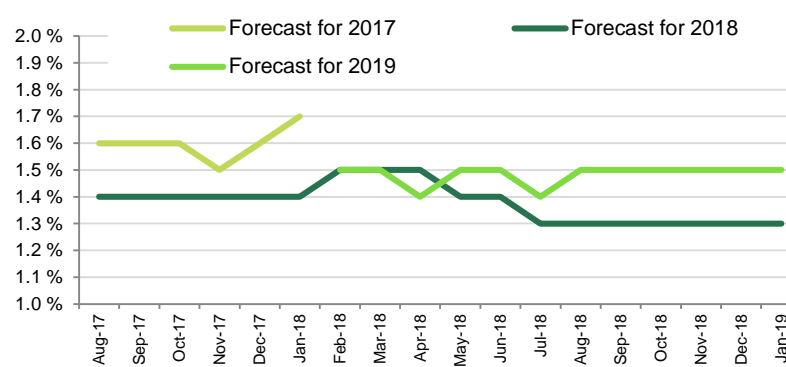
- The UK economy grew by 0.3% in the three months to November on the previous quarter. This expansion has been primarily driven by services, with the creative and life sciences sectors continuing to outperform. Manufacturing output has declined as the boost to competitiveness from a weak pound has been offset by domestic and global trade tensions. The PMIs suggest modest growth in December despite concerns around Brexit, product demand and labour availability.
- In the labour market, the unemployment rate has fallen to 4.0% (for the three months to November) and jobs growth has increased. Greater competition for scarcer labour has caused earnings growth to accelerate to 3.4% for the same period on last year – the fastest pace since 2008. Business capacity is being supported by part-time workers undertaking full-time positions and increasing labour force participation.
- Headline inflation, at 2.1% for the year to December, is the lowest since early 2017, and is likely to fall further. We believe that the Bank of England, conscious of risks to growth, will therefore raise interest rates only gradually. We expect one rise in Bank Rate in 2019. Falling inflation is also supporting real earnings growth, which is in turn driving retail sales. Volumes excluding fuel rose 2.9% in the three months to December on 2017, mainly driven by online purchases.

**Economic Drivers of Commercial Property Demand**



Source: CBRE, Oxford Economics, ONS

**Evolution of UK GDP Growth Forecasts**



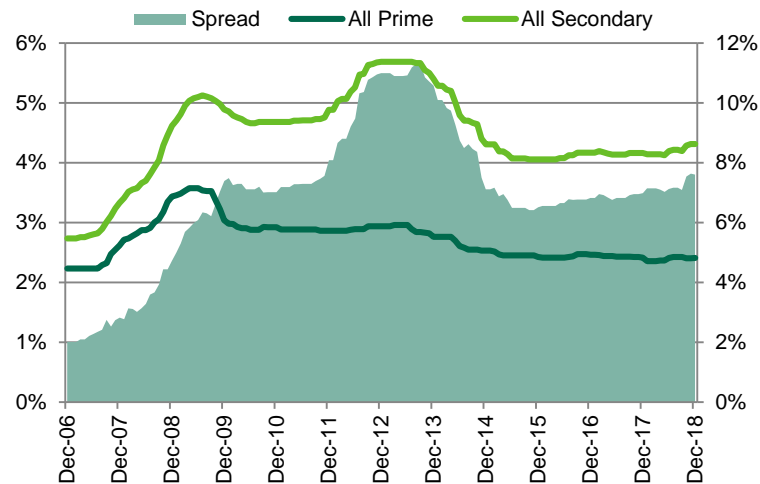
Source: HM Treasury Consensus

# PROPERTY MARKET & SECTOR FORECASTS

## Property Market Q4 2018

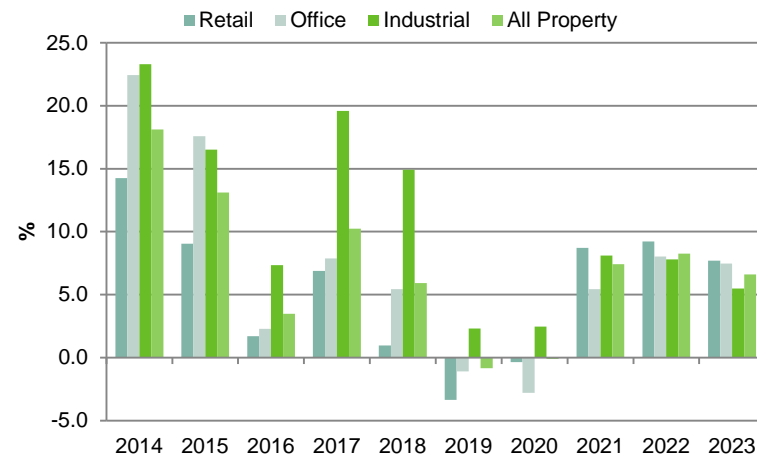
- Year on year total returns for All UK Property were 6.3% (0.8%\* capital return, 5.4%\* income return) for the period Q4 2017 to Q4 2018\*\*. Year on year returns at this level are lower than the 5 year average as the Retail sector's woes feed through to All Property level results.
- Quarterly total returns for All UK Property for Q4 recorded 0.4% (-0.9% capital return, 1.3% income return).
- Industrials again recorded a strong performance compared with other sectors in Q4 2018. Total returns in this sector were recorded at 4.0% (2.7% capital return, 1.2% income return), with capital value growth being notably above the 5 year quarterly average.
- Rental values for All UK Property decreased by -0.2% in the fourth quarter of 2018. This figure was largely pulled down by a fall of -1.7% in the Retail sector compared with an increase of 1.1% in the Industrial sector.

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



Source: CBRE Monthly Yields, December 2018

Property Total Returns



Source: IPD, CBRE, August 2018

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

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

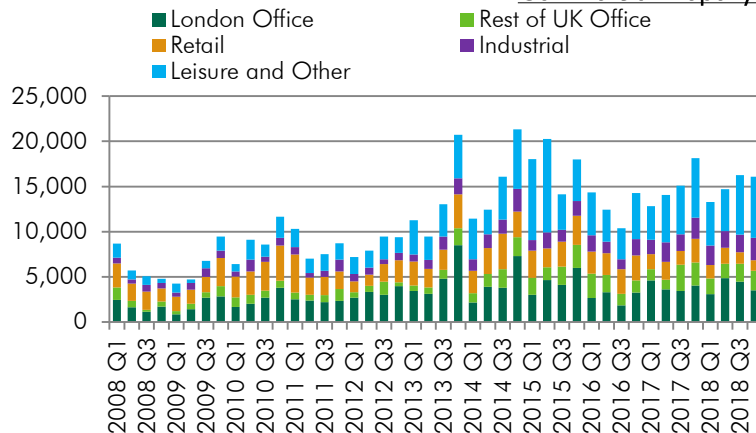


# PROPERTY MARKET & SECTOR FORECASTS

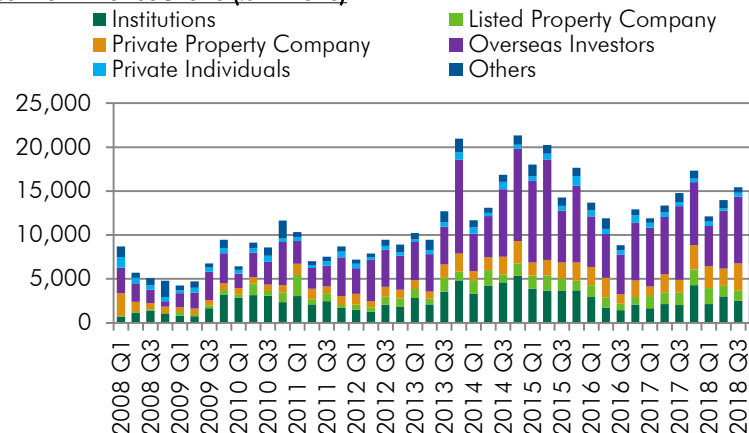
## Property Market Q4 2018 Transactions

- In Q4 2018, investors recorded a total transaction value for 'All Property' of £16.1bn. This is slight decrease from the £16.2bn reported in Q3, and the £18.2bn reported in Q4 2017.
- In Q4, 44% of investors were overseas investors. 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 17% of transactions in Q3 2018, which amounted to c. £2.8bn of investment. This is on par with the 16% reported in Q3.
- Investment transactions for 'All Offices' totalled £5.7bn in Q4 2018. Central London office investment recorded £4.4bn of capital deployed, accounting for 62% of total office investment for the quarter. The highest investment during this quarter was the purchase of 30 Gresham St in London for £425m.
- The Industrial sector saw £2.5bn in transaction activity in Q4 2018, reflecting the continued interest in this sector. The biggest deal of Q4 was Ascendas' purchase of an industrial portfolio for £257.5m.
- Retail transactions totalled £1.2bn for the quarter, with Norinchukin Bank and M&G purchasing Highcross Shopping Centre for £236m from Hammerson.

Commercial Property Investment Transactions (£millions)



Source: : CBRE, Property Data, January 2019



Source: CBRE, Property Data, January 2019

# PROPERTY MARKET & SECTOR FORECASTS

## UK Returns Forecast Q4 2018

	2016	2017	Forecast*					2023	Annualised 2019- 2023
			2018	2019	2020	2021	2022		
<b>Total return: % per year</b>									
Retail	1.7	6.9	0.9	0.9	-0.6	-0.6	7.1	8.8	3.1
Office	2.3	7.9	6.0	2.8	-0.3	-1.1	2.9	6.1	2.0
Industrial	7.3	19.6	15.5	6.5	-0.3	-3.7	5.3	7.6	3.0
All Property	3.5	10.2	6.3	3.2	-0.3	-1.5	5.1	7.3	2.7
<b>Income return: % per year</b>									
Retail	5.2	5.1	5.1	5.1	5.2	5.5	5.6	5.4	5.4
Office	4.1	4.1	4.0	4.0	4.2	4.4	4.5	4.4	4.3
Industrial	5.3	5.1	4.5	4.4	4.5	4.9	5.1	5.0	4.8
All Property	4.9	4.8	4.6	4.4	4.5	4.8	4.9	4.8	4.7
<b>Capital growth: % per year</b>									
Retail	-3.3	1.7	-4.0	-4.0	-5.5	-5.7	1.5	3.2	-2.2
Office	-1.7	3.6	1.9	-1.2	-4.3	-5.3	-1.6	1.6	-2.2
Industrial	2.0	13.9	10.5	2.0	-4.6	-8.2	0.2	2.5	-1.7
All Property	-1.3	5.2	1.7	-1.2	-4.6	-6.0	0.2	2.4	-1.9
<b>Nominal rental value growth: % per year</b>									
Retail	1.0	1.1	-1.5	-1.6	-0.6	0.2	0.5	1.2	-0.1
Office	2.9	1.5	0.8	0.4	0.1	-0.1	-1.0	1.0	0.1
Industrial	3.5	5.3	4.2	2.7	1.9	0.8	0.0	0.1	1.1
All Property	2.1	2.2	0.7	0.2	0.3	0.3	0.0	0.8	0.3
<b>Equivalent Yields - % at end year</b>									
Retail	5.7	5.5	5.7	5.7	6.0	6.3	6.1	6.0	0.3
Office	6.0	5.8	5.6	5.6	5.8	6.1	6.0	5.9	0.3
Industrial	6.3	5.7	5.3	5.3	5.6	6.1	6.0	5.8	0.5
All Property	5.9	5.6	5.4	5.5	5.7	6.0	5.9	5.7	0.3

\*Forecast figures based on Q4 2018 quarterly valuations

Source: CBRE, Q4 2018

We expect mixed performance across sectors over the forecast period. Structural shifts in consumer spending habits are being compounded by Brexit uncertainty and varying supply and demand dynamics.

All Property Total Returns for 2018, at 6.3%, are expected to be lower than last year. This is owing primarily to an outward shift in retail yields. The industrial sector will likely continue to outperform other sectors, with the structural shift toward logistics space and constrained supply continuing to drive greater competition for assets. We expect All Property Returns to have a decreasing trend and be slightly negative in 2020 and 2021. This is due to yields shifting outward in line with interest rates and a slowing global and UK economy as projected in the CBRE macroeconomic house view. A recovery in yields and the economy then follows. The 5-year annualised total return for 2019-2023 is 2.7% per annum.

Moderate rental decline is forecast in the office sector while industrial rental growth continues, albeit at a slower pace, and retail rental growth becomes slightly negative. 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.

# 3 PORTFOLIO STRATEGY AND FORECASTING

# PORTFOLIO STRATEGY AND FORECASTING

## Portfolio Strategy

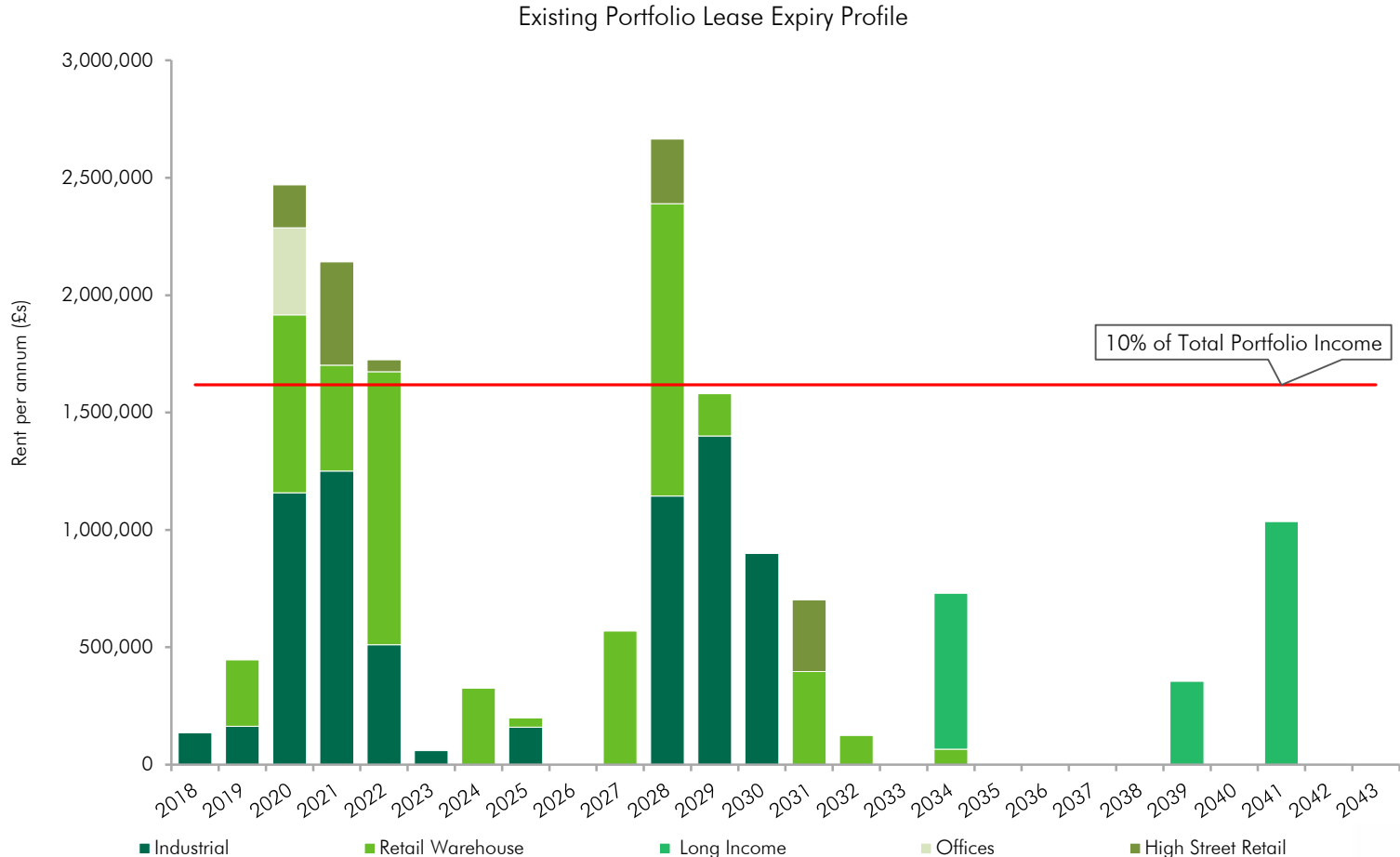
### Top Down Strategy

- The Teesside Pension Fund was valued at approximately £4.16bn in September 2018. The Direct Property Portfolio held by the Fund was valued at £303.95m (Dec-18), equating to 7.3% 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.
- 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

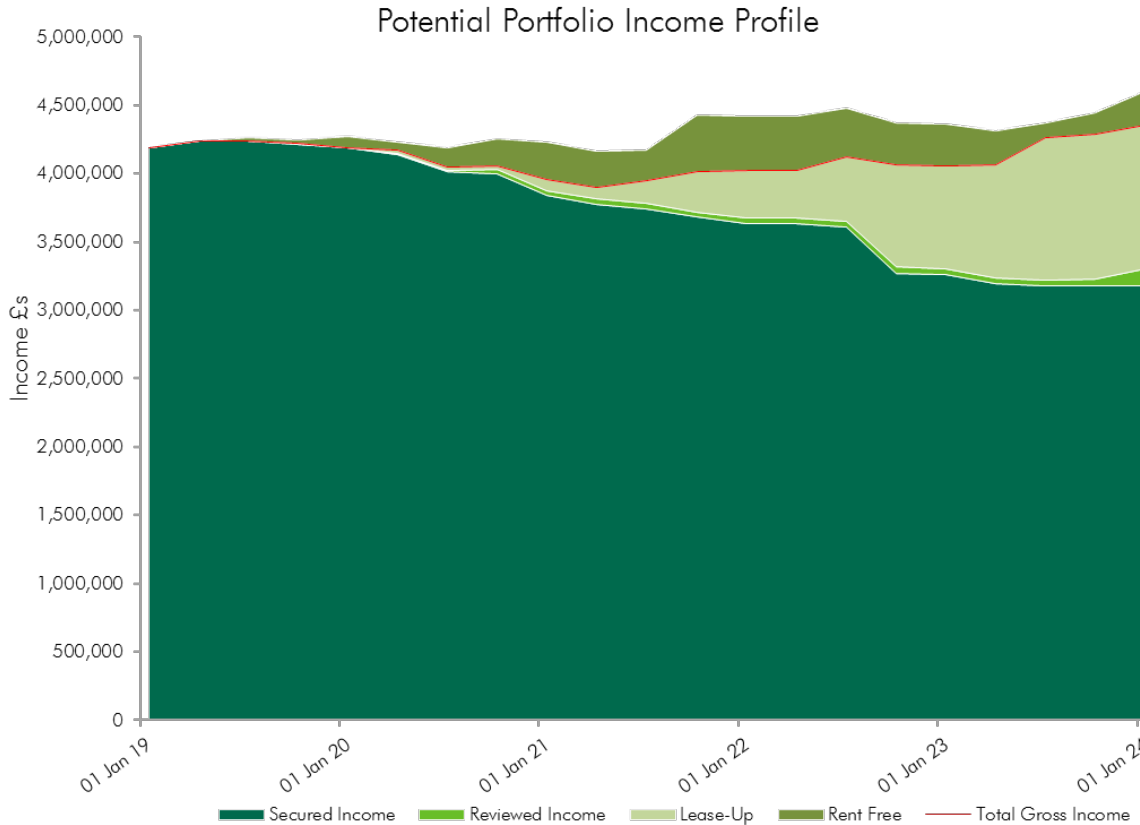




# PORTFOLIO POSITIONING AND FORECASTING

## 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	11.3%
South East	9.8%
South West	11.4%
East	7.1%
West Midlands	22.9%
North East	31.6%
North West	3.9%
Scotland	1.8%
<b>Total</b>	<b>100%</b>

SECTOR	% OF PORTFOLIO (RENTAL VALUE)
Industrial	40.1%
Retail Warehouse	32.3%
High Street Retail	11.1%
Long Income	2.2%
Offices	14.2%
<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	8.36%	1	09 September 2029
2	Libra Textiles	129,952	£1,035,000	£1,040,000	6.18%	1	04 April 2041
3	B&Q plc	107,068	£997,000	£1,025,000	5.96%	2	31 January 2027
4	Royal Mail Group Limited	207,572	£899,162	£1,000,000	5.37%	1	23 September 2030
5	DHL Supply Chain Ltd.	146,138	£868,635	£875,000	5.19%	1	28 September 2021
6	Brunel Healthcare	136,342	£844,368	£650,000	5.04%	1	10 April 2028
7	H&M	32,501	£740,000	£740,000	4.42%	1	23 June 2024
8	Tesco Stores Limited	25,084	£664,016	£570,000	3.97%	1	28 July 2034
9	P&O Ferrymasters Limited	122,157	£662,000	£685,000	3.95%	1	25 December 2020
10	Matalan Retail Limited	51,753	£500,000	£500,000	2.99%	1	27 November 2028
11	Barclays	18,833	£450,000	£470,000	2.69%	1	23 June 2025
12	HSBC Bank Plc	2,016	£440,000	£460,000	2.63%	1	18 October 2021
13	Wickes Building Supplies Limited	28,338	£396,750	£396,750	2.37%	1	29 September 2028
14	DSG Retail Limited (t/a Currys/PC World)	25,000	£375,000	£375,000	2.24%	1	28 September 2022
15	B&M Retail Limited (t/a B&M Homestore)	25,000	£375,000	£375,000	2.24%	1	28 September 2022
16	Institute of Cancer Research	9,502	£371,420	£371,420	2.22%	1	17 February 2020
17	Nuffield Health	26,458	£354,715	£331,000	2.12%	1	04 April 2039
18	Pets at Home Ltd	15,577	£325,825	£325,500	1.95%	2	05 January 2024
19	Aurum Group Limited	1,440	£305,000	£305,000	1.82%	1	01 March 2031
20	Halycon Fine Art Ltd	38,722	£300,000	£525,000	1.79%	1	22 December 2028
<b>TOTAL</b>	<b>TOTAL</b>	<b>1,470,268</b>	<b>£12,303,891</b>	<b>£12,419,670</b>	<b>73.5%</b>	<b>22</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 on occupier interest on both a whole and split unit basis. These opportunities are currently being reviewed to assess the best option moving forward.

### Bromford Central, Birmingham

- Wolseley UK Ltd have now vacated Unit 4. CBRE have been instructed to Specify and Administer Repair Works to the unit; Harris Lamb have been instructed to re-let the unit. A schedule of dilapidations is to be served on Wolseley UK Ltd imminently. A reversionary lease has been agreed with AKW at Unit 6 at a rent of £195,000, the tenant is currently in a rent free period, expiring March 2019. Renewal discussions with the tenant at Unit 3 are ongoing

### 123 Old Brompton Road, London

- A dispute with the residential long-leaseholders regarding repair works to the roof and balconies is ongoing. The dispute predominantly revolves around a mismanagement of the works tender, by a third party property management company that were appointed prior to CBRE's instruction. The incumbent property management firm have been relieved of their role and Knight Frank Property Management have been appointed in their stead.

### Bingley Retail Park, Keighley

- Homebase have vacated their unit following the company entering into a CVA. A new 10 year lease to B&M has been agreed, with the Tenant having entered the unit to undertake their shop fit-out on the 7th January 2019, following the Fund receiving Vacant Possession of the property. The new rent totals £250,000 pa.





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