

**CBRE**

# **TEESSIDE PENSION FUND**

## **Quarterly Portfolio Strategy Report**

**1<sup>ST</sup> JANUARY 2019 TO 31<sup>ST</sup> MARCH 2019**

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	41.9%	40.2%
Retail Warehouse	28.1%	30.0%
Long Income	12.0%	18.5%
Offices	2.5%	2.5%
High Street Retail	15.5%	8.8%
	100%	100%

# EXECUTIVE SUMMARY

## Portfolio Profile

- At 31<sup>st</sup> March 2019 the portfolio comprised 28 mixed-use properties located throughout the UK, with a combined value of £300.70m. 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 85.5% 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 7.8 years to the earlier of first break or expiry, and 9.6 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 Q4 2018' confirmed an 'all sectors' average void rate of 6.7%.
  - The top ten tenants constitute 50.5% of the total gross annual income of the portfolio, while the top twenty tenants constitute 73.1%.
  - Current gross passing rent is £17,109,722 per annum, against a gross current market rent of £17,556,622 per annum, making the portfolio reversionary in nature.

# EXECUTIVE SUMMARY

## Portfolio Activity

### Investments

### Sales

- No sales this period.

### Acquisitions

- No acquisitions this period.

# EXECUTIVE SUMMARY

## Portfolio Activity And Strategy

### Portfolio arrears at 7<sup>th</sup> May 2019

The total Collectable Arrears on the entire portfolio is £12,690.02 at 7th May 2019. The Collectable Arrears exclude the following:

- Tenants that are insolvent (99p Stores Limited at Cirencester and HHGL Limited at Bingley).
- Tenants that are charged rent quarterly but pay monthly and are up to date (B&Q plc at Hull, Aurum Group Limited at Newcastle and J.F. Stone Investments Ltd at Gloucester Road)
- The annual insurance premium as this was raised within the last month.
- Tenants that have overall credit balances on their accounts.

Of the Collectable Arrears, 64.8% (£8,228.91) relates to the following four tenants:

- B&Q plc (Arbroath) – Total arrears of £3,146.44 (24.8% of the collectable arrears). This primarily relates to two service charge payments, which were due on 28/11/2017 and 28/02/2018. All other charges have been paid in full. These old arrears relate to a service charge dispute and a restructure for the whole property. The Surveyor has been working closely with the tenant and their agent (Profile Consultancy) and is also liaising with the client's Solicitor to resolve a few specific points. Discussions are continuing. The overall arrears level has reduced as a credit has been applied to the account as the service charge is being brought up to date.
- Partridges of Sloane Street Ltd (Gloucester Road, London) – Total arrears of £2,607.64 (20.5% of the collectable arrears). This relates solely to the head landlord's service charge that we have recharged. This is a single quarter's charge that was due on 1st April. This has not been disputed and we are chasing for payment.
- Toni & Guy (South) Ltd (Gloucester Road, London) – Total arrears of £1,372.44 (10.8% of the collectable arrears). As above, this relates solely to the head landlord's service charge that we have recharged. This is a single quarter's charge that was due on 1st April. This has not been disputed and we are chasing for payment.
- Barclays Bank plc (Exeter) – Total arrears of £1,102.39 (8.7% of the collectable arrears). This relates solely to the insurance premium for the period from property purchase to the policy renewal date. The tenant is questioning the level of premium despite the overall level being cheaper than under the previous ownership. We are working with the tenant to resolve this.

The remaining 35.2% of the Collectable Arrears (£4,461.11) relate to 18 different tenant accounts; all of which are being chased.

# EXECUTIVE SUMMARY

## Rent Collection Statistics

### Rent Collection Statistics at 25<sup>th</sup> March 2019

			Targets	92.00%	96.00%	98.00%	99.00%		
	Rent Due 25 March	Collectable Rent	Quarter Date up to and including 25/03/2019	Week 1 up to and including 01/04/2019	Week 2 up to and including 08/04/2019	Week 3 up to and including 15/04/2019	Week 4 up to and including 22/04/2019	Payment after 22/04/2019	Difference
Non Collectable Total	4,589,133	4,370,633	3,913,090	142,520	298,765	16,259	0	105,000	-105,000
Collections Including non collectables		218,500							
Collections Excluding non collectables			85.27%	88.37%	94.88%	95.24%	95.24%	97.53%	
			89.53%	92.79%	99.63%	100.00%	100.00%	102.40%	

These figures relate to rents that only became due on the December English Quarter Day (25<sup>th</sup> March 2019).

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.



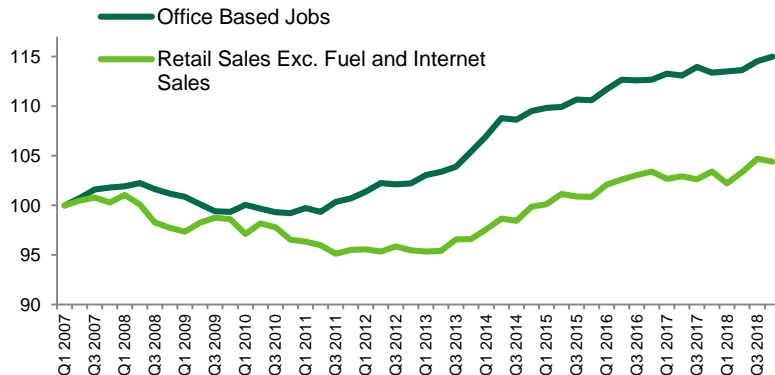
## 2 ECONOMIC PERFORMANCE AND PROPERTY MARKET

# PROPERTY MARKET & SECTOR FORECASTS

## Economic Performance Q1 2019

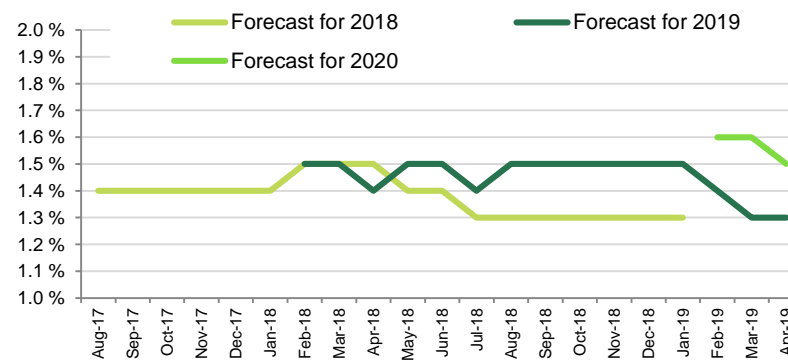
- The UK economy grew by 0.3% over the three months to the end of February against the previous three months, confounding market expectations of stagnation. This resilience can mainly be attributed to the services sector and a recovery in manufacturing output. The information & communication subsector continues to outperform, while a mild period of weather has bolstered wholesale & retail activity, especially in comparison to Q1 last year.
- The labour market continues to defy expectations of a slowdown, with the employment rate reaching a record high of 76.1% in the three months to January. With unemployment also falling further, labour scarcity and wage growth, at 3.4%, have increased. Income growth is receiving additional support from the movement of workers into higher-paying, full-time positions.
- Inflation, at 1.9% in February, now sits comfortably below wage growth and, given strong jobs figures, will provide support to household incomes. Surveys indicate that these positive effects are for now being more than offset by Brexit-related uncertainty dampening consumer confidence. Given risks to the growth outlook and moderate inflationary pressures, we expect no increase in interest rates this year.

**Economic Drivers of Commercial Property Demand**



Source: CBRE, Oxford Economics, ONS

**Evolution of UK GDP Growth Forecasts**



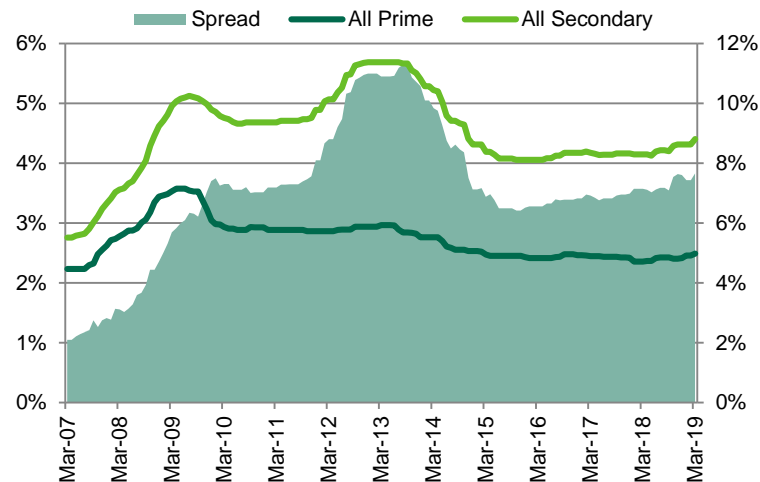
Source: HM Treasury Consensus

# PROPERTY MARKET & SECTOR FORECASTS

## Property Market Q1 2019

- Year on year total returns for All UK Property were 4.7% (-0.7%\* capital return, 5.4%\* income return) for the period Q1 2018 to Q1 2019\*\*. Year on year returns at this level are lower than the 5 year average as the Retail sector's woes continue to feed through to All Property level results.
- Quarterly total returns for All UK Property for Q1 recorded 0.7% (-0.6% capital return, 1.3% income return).
- Industrials again recorded a strong performance compared with other sectors in Q1 2019. Total returns in this sector were recorded at 1.9% (0.7% capital return, 1.2% income return).
- Rental values for All UK Property were stable in the first quarter of 2019. This figure was largely pulled down by a fall of -0.9% in the Retail sector compared with an increase of 0.8% in the Industrial sector.

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

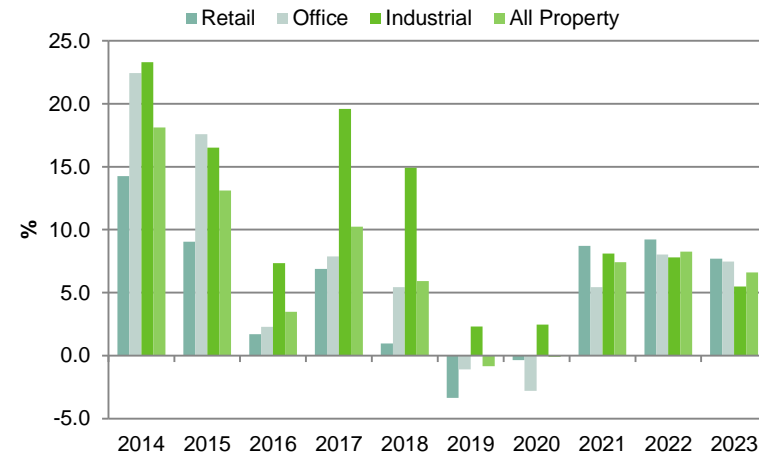


Source: CBRE Monthly Yields, March 2019

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

\*\* Based on CBRE Monthly Index, all property total returns March 2019

Property Total Returns

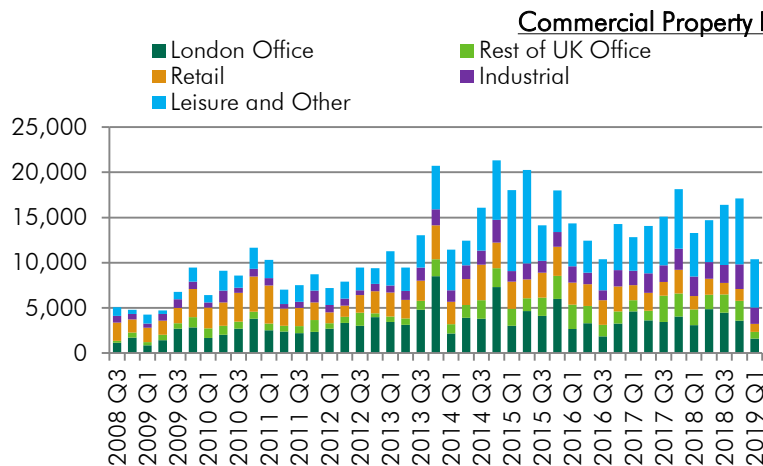


Source: IPD, CBRE, March 2019

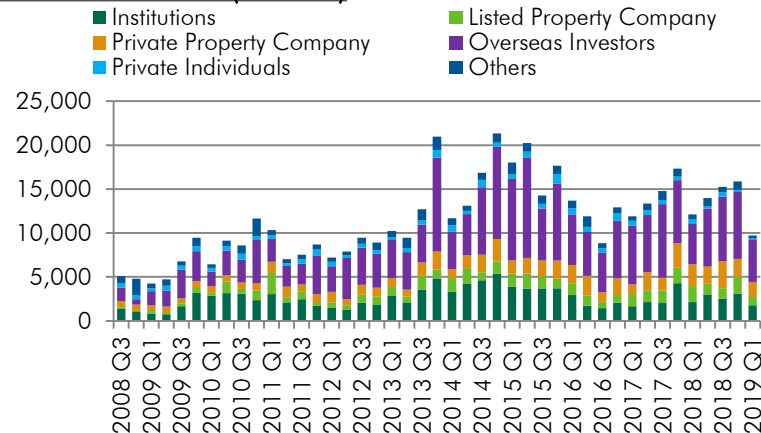
# PROPERTY MARKET & SECTOR FORECASTS

## Property Market Q1 2019 Transactions

- In Q1 2019, investors recorded a total transaction value for 'All Property' of £10.4bn. This is significant decrease from the £17.1bn reported in Q4, and the £13.3bn reported in Q1 2018.
- In Q1, 49% 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 18% of transactions in Q1 2019, which amounted to c. £1.8bn of investment. This is on par with the 19% reported in Q4 2018.
- Investment transactions for 'All Offices' totalled £2.3bn in Q1 2019. Central London office investment recorded £1.6bn of capital deployed, accounting for 68% of total office investment for the quarter. The highest investment during this quarter was the purchase of 42-47 Minories in London for £121m.
- The Industrial sector saw £1.8bn in transaction activity in Q1 2019, reflecting the continued interest in this sector. The biggest deal of Q1 was Tritax's purchase of an industrial portfolio for £250.5m.
- Retail transactions totalled £0.9bn for the quarter, with Ashby Capital purchasing Kensington Arcade for £200m from Colombia Threadneedle.



Source: : CBRE, Property Data, May 2019



Source: CBRE, Property Data, May 2019

# PROPERTY MARKET & SECTOR FORECASTS

## UK Returns Forecast Q1 2019

	2016	2017	2018	Forecast					Annualised
				2019	2020	2021	2022	2023	2019-2023
<b>Total return: % per year</b>									
Retail	1.7	6.9	-0.5	-1.9	-0.1	1.0	7.2	8.7	2.9
Office	2.3	7.9	6.2	1.4	-1.1	-0.8	4.4	7.7	2.3
Industrial	7.3	19.6	16.4	4.9	0.0	0.0	6.2	7.7	3.7
All Property	3.5	10.2	6.0	1.2	-0.3	0.3	5.8	7.8	2.9
<b>Income return: % per year</b>									
Retail	5.2	5.1	5.1	5.2	5.4	5.6	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	4.7	4.8	4.7	4.6
All Property	4.9	4.8	4.6	4.4	4.5	4.7	4.8	4.7	4.6
<b>Capital growth: % per year</b>									
Retail	-3.3	1.7	-5.3	-6.8	-5.2	-4.3	1.5	3.1	-2.4
Office	-1.7	3.6	2.1	-2.5	-5.1	-5.0	-0.1	3.1	-2.0
Industrial	2.0	13.9	11.4	0.5	-4.3	-4.6	1.3	2.9	-0.9
All Property	-1.3	5.2	1.4	-3.1	-4.6	-4.3	1.0	3.0	-1.6
<b>Nominal rental value growth: % per year</b>									
Retail	1.0	1.1	-2.2	-1.4	-0.7	-0.6	0.2	1.2	-0.3
Office	2.9	1.5	0.8	0.2	-0.1	-1.0	-0.3	1.8	0.1
Industrial	3.5	5.3	4.6	3.1	2.0	0.9	0.4	0.4	1.3
All Property	2.1	2.2	0.5	0.3	0.3	-0.2	0.3	1.3	0.4
<b>Equivalent Yields - % at end year</b>									
Retail	5.7	5.5	5.7	5.9	6.1	6.3	6.1	5.9	0.3
Office	6.0	5.8	5.6	5.6	5.9	6.0	5.9	5.7	0.1
Industrial	6.3	5.7	5.3	5.4	5.7	5.9	5.8	5.6	0.3
All Property	5.9	5.6	5.5	5.5	5.8	5.9	5.8	5.6	0.2

\*Forecast figures based on Q1 2019 quarterly valuations

Source: CBRE, Q1 2019

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 2019, at 1.2%, 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 combined with a more constrained supply than is seen with other key sectors. We expect All Property Returns to have a decreasing trend and be slightly negative in 2020 before an uptick in growth again. 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 2.9% 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 remains slightly negative in the near term. 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

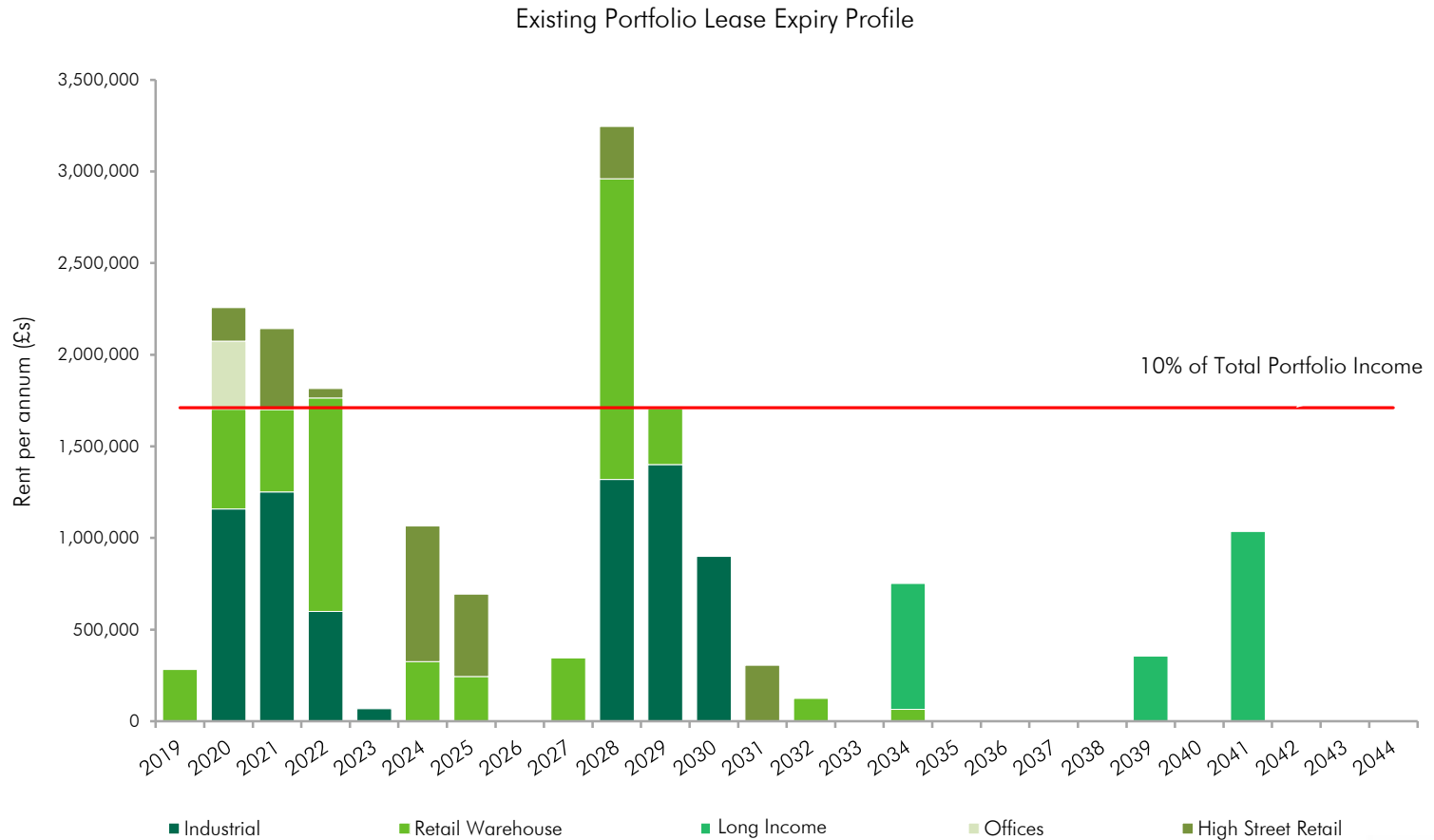
### Top Down Strategy

- The Teesside Pension Fund was valued at approximately £3.84bn in December 2018. The Direct Property Portfolio held by the Fund was valued at £300.70m (Mar-19), equating to 7.2% 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

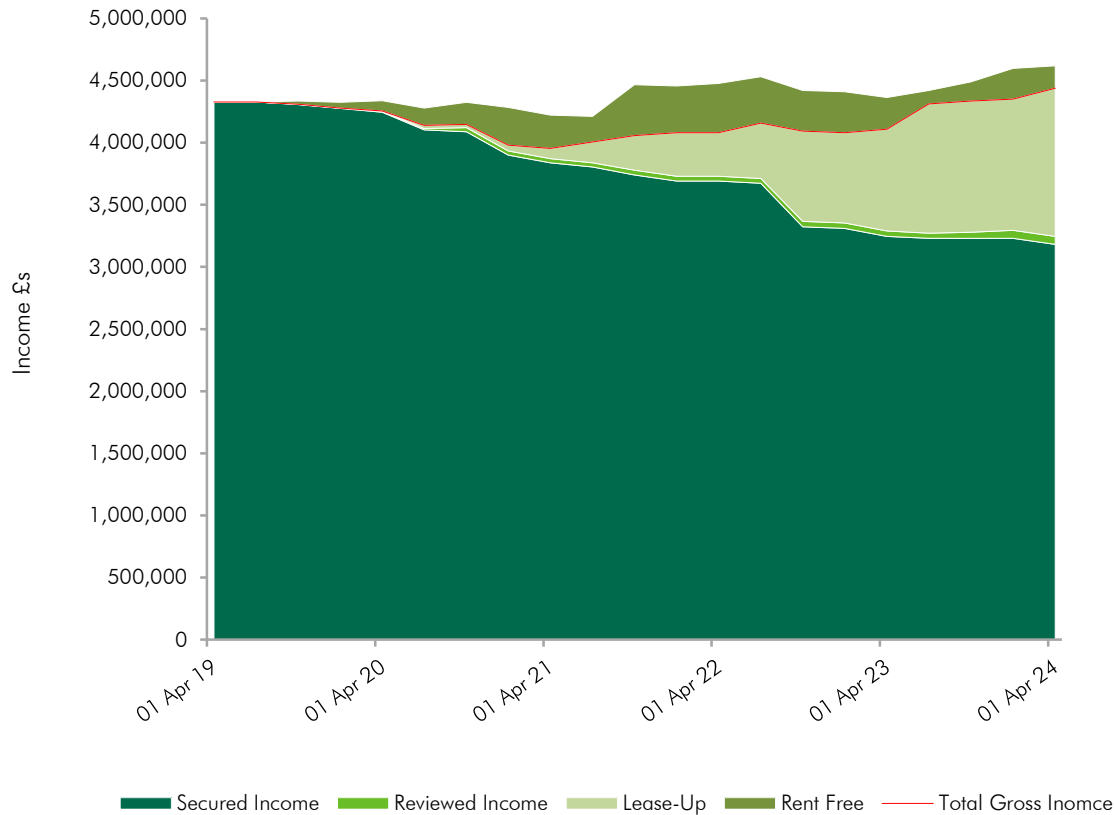




# PORTFOLIO POSITIONING AND FORECASTING

## 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	11.5%
South East	9.8%
South West	11.0%
East	7.2%
West Midlands	23.5%
North East	31.3%
North West	4.0%
Scotland	1.8%
<b>Total</b>	<b>100%</b>

SECTOR	% OF PORTFOLIO (RENTAL VALUE)
Industrial	41.9%
Retail Warehouse	28.1%
High Street Retail	12.0%
Long Income	2.5%
Offices	15.5%
<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	8.18%	1	09-Sep-29
2	Libra Textiles	129,952	£1,035,000	£1,040,000	6.05%	1	04-Apr-41
3	B&Q plc	107,068	£997,000	£1,025,000	5.83%	2	31-Jan-27
4	Royal Mail Group Limited	207,572	£899,162	£1,000,000	5.26%	1	23-Sep-30
5	DHL Supply Chain Ltd.	146,138	£868,635	£875,000	5.08%	1	28-Sep-21
6	Brunel Healthcare	136,342	£843,761	£650,000	4.93%	1	10-Apr-28
7	H&M	32,501	£740,000	£740,000	4.33%	1	23-Jun-24
8	Tesco Stores Limited	25,084	£686,011	£570,000	4.01%	1	28-Jul-34
9	P&O Ferrymasters Limited	122,157	£662,000	£685,000	3.87%	1	25-Dec-20
10	Matalan Retail Limited	51,753	£500,000	£500,000	2.92%	1	27-Nov-28
11	Halycon Fine Art Ltd	38,722	£475,000	£500,000	2.78%	1	22-Dec-28
12	Barclays	18,833	£450,000	£470,000	2.63%	1	23-Jun-25
13	HSBC Bank Plc	2,016	£440,000	£460,000	2.57%	1	18-Oct-21
14	Wickes Building Supplies Limited	28,338	£396,750	£396,750	2.32%	1	29-Sep-28
15	DSG Retail Limited (t/a Currys/PC World)	25,000	£375,000	£375,000	2.19%	1	28-Sep-22
16	B&M Retail Limited (t/a B&M Homestore)	25,000	£375,000	£375,000	2.19%	1	28-Sep-22
17	Institute of Cancer Research	9,502	£371,420	£371,420	2.17%	1	17-Feb-20
18	Nuffield Health	26,458	£354,715	£331,000	2.07%	1	04-Apr-39
19	Pets at Home Ltd	15,577	£325,825	£325,850	1.90%	2	05-Jan-24
20	Aurum Group Limited	1,440	£305,000	£305,000	1.78%	1	01-Mar-31
<b>TOTAL</b>		<b>1,470,268</b>	<b>£12,500,279</b>	<b>£12,395,020</b>	<b>73.06%</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 has been served on Wolseley UK Ltd imminently, negotiations are ongoing. Inco have been instructed to carry out the dilapidations works these have begun within the last month. Rent reviews at Units 1 & 2 have been completed securing a total uplift of 12% on the previous passing rent.

### 123 Old Brompton Road, London

- The residential Property Manager is engage to produce a schedule of repairs and cost estimate for consideration by the Tenants.

### 17-23 Gloucester Road, London

- A reversionary lease has been agreed with Partridges at Gloucester Road. The terms are largely similar to their current occupation (expiring December 2020). The reversionary lease will ensure an extension of the term certain through until 24<sup>th</sup> December 2030. The rent is to be £140,000 pa, with a single upwards only rent at the 5<sup>th</sup> anniversary of the term.

The CBRE logo is displayed in a bold, white, sans-serif font in the upper left corner of the slide. The background of the entire slide is a dark green, abstract geometric pattern of overlapping polygons and lines, creating a sense of depth and structure.

**CBRE**

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