Agenda Item 8 - CBRE Property Report

CBRE

# TEESSIDE PENSION FUND

## Quarterly Portfolio Strategy Report

1ST APRIL 2019 TO 30TH JUNE 2019

PREPARED FOR

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# CONTENTS

# 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 | 43.1% | 40.2% |
| Retail Warehouse | 28.2% | 30.0% |
| Long Income | 11.1% | 18.5% |
| Offices | 2.6% | 2.5% |
| High Street Retail | 15.0% | 8.8% |
| | 100% | 100% |

# EXECUTIVE SUMMARY
## Portfolio Profile

- At 30th June 2019 the portfolio comprised 28 mixed-use properties located throughout the UK, with a combined value of £292.4m. This reflects an overall Net Initial Yield of 5.50%, and an Equivalent Yield of 5.65%.

- The portfolio comprises principally prime and good secondary assets. High Street retail, retail warehouse and industrial comprise 86.3% 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 7.6 years to the earlier of first break or expiry, and 9.4 years to expiry, ignoring break dates.

- The portfolio also has the following characteristics:

  - The vacancy rate is currently 1.2% of Estimated Rental Value. By comparison, the 'IRIS Digest Q1 2019' confirmed an 'all sectors' average void rate of 7.1%.

  - The top ten tenants constitute 50.1% of the total gross annual income of the portfolio, while the top twenty tenants constitute 72.5%.

  - Current gross passing rent is £17,130,101 per annum, against a gross current market rent of £17,338,622 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 19th July 2019

**The total Collectable Arrears on the entire portfolio is £106,423.93 at 19th July 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 quarterly and 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 that have overall credit balances on their accounts.

**Of the Collectable Arrears, 85.9% (£91,438.24) relates to the following seven tenants:**

- My Realisations Ltd (In Administration) – Total arrears of £40,194.37 (37.8% of the collectable arrears). This is mainly the June quarter rent and service charge and we are continuing to chase for payment.
- DHL and Unipart (Rugby) – Total arrears of £11,993.65 (11.3% of the collectable arrears). This relates solely to the annual insurance premium, which was charged to DHL, who then assigned their lease to Unipart Logistics Ltd. This sum is being split and recharged to the two tenants individually.
- P&O Ferrymasters Ltd (Lutterworth) – Total arrears of £10,212.25 (9.6% of the collectable arrears). This relates solely to the annual insurance premium and is being chased.
- Knight Frank (Old Brompton Road) – Total arrears of £8,922.34 (8.4% of the collectable arrears). This relates solely to the annual insurance premium for the residential element of the building and is being chased.
- Barclays Bank plc (Exeter) – Total arrears of £8,647.55 (8.1% of the collectable arrears). This relates solely to the annual insurance premium and is being chased.
- Nuffield Health (Guildford) – Total arrears of £5,837.11 (5.5% of the collectable arrears). This relates solely to the annual insurance premium and is being chased.
- Pizza Hut (UK) Ltd (Ipswich) – Total arrears of £5,630.97 (5.3 of the collectable arrears). This relates mainly to rent from the settlement of the old rent review, which continues to be chased.

**The remaining 14.1% of the Collectable Arrears (£14,985.69) relate to 28 different tenant accounts; all of which are being chased.**

# EXECUTIVE SUMMARY

## Rent Collection Statistics

### Rent Collection Statistics at 24th June 2019

| Debtor Name | Rent Due 24 June | Collectable Rent | Quarter Date up to and including 24/06/2019 | Week 1 up to and including 01/07/2019 | Week 2 up to and including 08/07/2019 | Week 3 up to and including 15/07/2019 | Week 4 up to and including 22/07/2019 | Payment after 22/07/2019 | Difference |
|---|---|---|---|---|---|---|---|---|---|
| | | | Targets | 92.0% | 96.0% | 98.0% | 99.0% | | |
| | 4,592,969.09 | 4,481,918.40 | 3,706,942.79 | 314,993.20 | 182,197.50 | 4,250.00 | 0.00 | 236,303.46 | 37,231.45 |
| Non Collectable Total | | 111,050.69 | | | | | | | |
| Collections Including non collectables | | | 80.7% | 87.6% | 91.5% | 91.6% | 91.6% | 96.8% | |
| Collections Excluding non collectables | | | 82.7% | 89.7% | 93.8% | 93.9% | 93.9% | 99.2% | |

These figures relate to rents that only became due on the December English Quarter Day (24th June 2019).

The total non-collectable sum equates to £111,051. This relates to; B&Q Plc, Hull (£72,051), Aurum Group Ltd (£30,500) 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 22nd November 2017.

# 2 ECONOMIC PERFORMANCE AND PROPERTY MARKET

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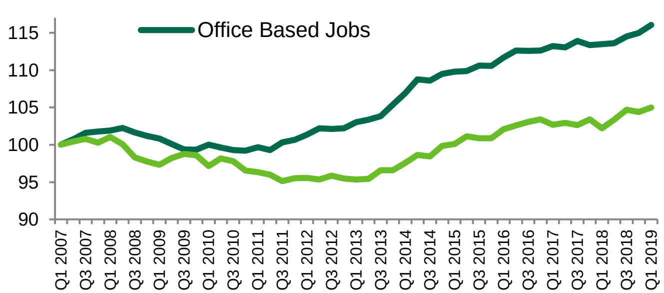
# PROPERTY MARKET & SECTOR FORECASTS

## Economic Performance Q2 2019

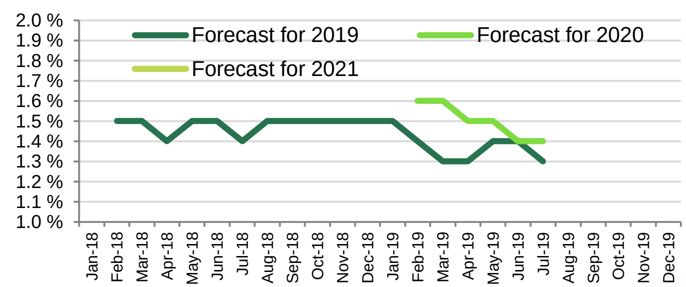
- The UK economy grew moderately at 0.3% over the rolling three month period to the end of May, declining 0.1% from the previous rolling three months, confounding market expectations of stagnation. This resilience can mainly be attributed to the services and production sectors growing by 0.3% in the three months leading up to May, combined with a recovery in manufacturing output (after April shutdowns). 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 maintaining highs of 76.0% in the three months to May. Unemployment has stabilised at 3.8%, labour scarcity and wage growth, at 3.6%, have increased. Income growth is receiving additional support from the movement of workers into higher-paying, full-time positions.
- Inflation, at 2.0% in May, 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.

<u>Economic Drivers of Commercial Property Demand</u>




*Source: CBRE, Oxford Economics, ONS*

<u>Evolution of UK GDP Growth Forecasts</u>




*Source: HM Treasury Consensus*

# PROPERTY MARKET & SECTOR FORECASTS
## Property Market Q2 2019

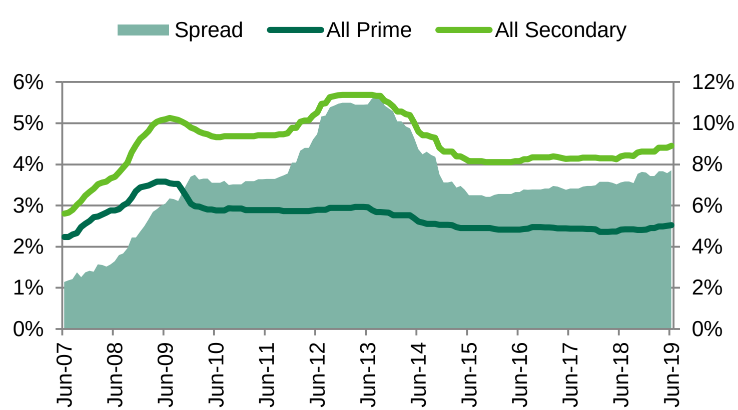
- Year on year total returns for All UK Property were 3.5% (-1.8%* capital return, 5.4%* income return) for the period Q2 2018 to Q2 2019**. Year on year returns at this level are lower than the 5 year average as the Retail sector's woes continue to feed through to All Property level results.

- Quarterly total returns for All UK Property for Q2 recorded 0.8% (-0.6% capital return, 1.4% 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).

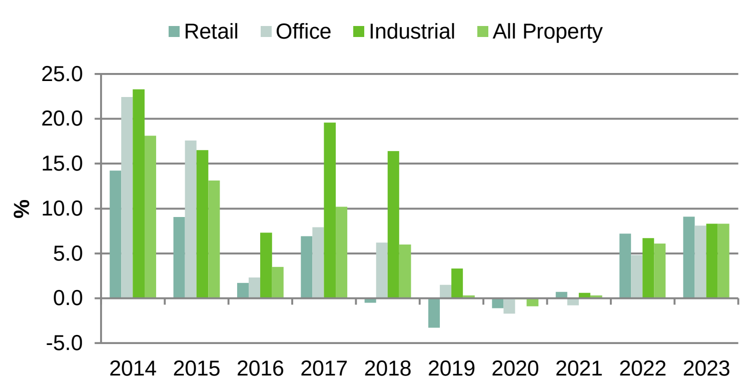
- Rental values for All UK Property decreased -0.1% in the second quarter of 2019. This figure was largely pulled down by a fall of -0.8% in the Retail sector compared with an increase of 0.7% in the Industrial sector.

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




*Source: CBRE Monthly Yields, June 2019*

Property Total Returns




*Source: MSCI, CBRE, May 2019*

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

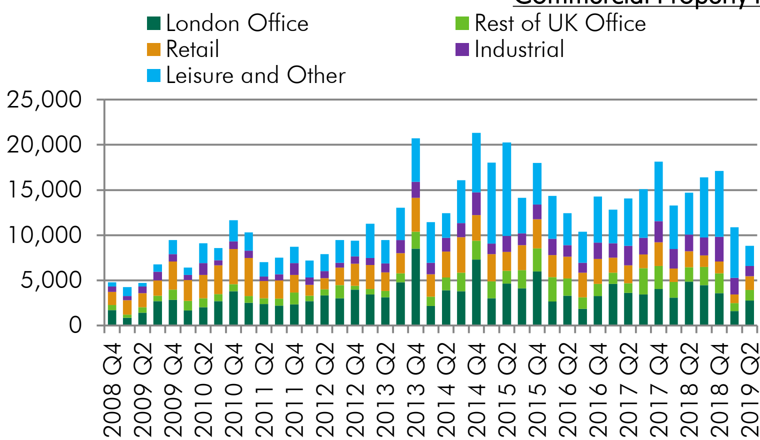
** *Based on CBRE Monthly Index, all property total returns June 2019*

# PROPERTY MARKET & SECTOR FORECASTS

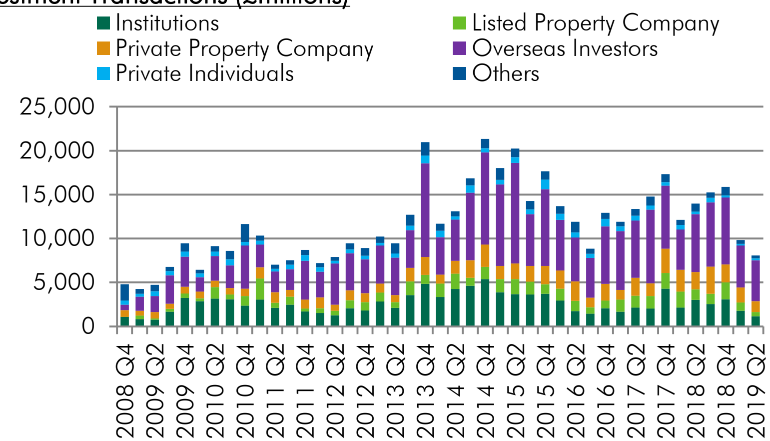
## Property Market Q2 2019 Transactions

- In Q2 2019, investors recorded a total transaction value for 'All Property' of £8.8bn. This is significant decrease from the £10.8bn reported in Q4, and the £15.6bn reported in Q2 2018.
- In Q2, 53% 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 13% of transactions in Q2 2019, which amounted to c. £1.2bn of investment. This is down slightly on the 15% reported in Q1 2019.
- Investment transactions for 'All Offices' totalled £3.9bn in Q2 2019. Central London office investment recorded £2.8bn of capital deployed, accounting for 70% of total office investment for the quarter. The highest investment during this quarter was Citigroup's purchase of 25 Canada Square for £1.1bn.
- The Industrial sector saw £1.1bn in transaction activity in Q2 2019, reflecting the continued interest in this sector. The biggest deal of Q2 was the sale of Brook Park, Shirebrook for £120m.
- Retail transactions totalled £1.5bn for the quarter, with Realty Income purchasing a portfolio of Sainsburys Superstores for £429m.

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




*Source: : CBRE, Property Data, July 2019*




*Source: CBRE, Property Data, July 2019*

# PROPERTY MARKET & SECTOR FORECASTS

## UK Returns Forecast Q2 2019

| | 2016 | 2017 | 2018 | 2019 (Forecast) | 2020 (Forecast) | 2021 (Forecast) | 2022 (Forecast) | 2023 (Forecast) | Annualised 2019-2023 |
|---|---|---|---|---|---|---|---|---|---|
| **Total return: % per year** | | | | | | | | | |
| Retail | 1.7 | 6.9 | -0.5 | -3.3 | -1.1 | 0.7 | 7.2 | 9.1 | 2.4 |
| Office | 2.3 | 7.9 | 6.2 | 1.5 | -1.7 | -0.8 | 4.8 | 8.1 | 2.3 |
| Industrial | 7.3 | 19.6 | 16.4 | 3.3 | -0.1 | 0.6 | 6.7 | 8.3 | 3.7 |
| All Property | 3.5 | 10.2 | 6.0 | 0.3 | -0.9 | 0.3 | 6.1 | 8.3 | 2.8 |
| **Income return: % per year** | | | | | | | | | |
| Retail | 5.2 | 5.1 | 5.1 | 5.2 | 5.4 | 5.6 | 5.6 | 5.4 | 5.5 |
| Office | 4.1 | 4.1 | 4.0 | 4.1 | 4.2 | 4.4 | 4.5 | 4.4 | 4.3 |
| Industrial | 5.3 | 5.1 | 4.5 | 4.4 | 4.6 | 4.8 | 4.9 | 4.7 | 4.7 |
| All Property | 4.9 | 4.8 | 4.6 | 4.5 | 4.6 | 4.8 | 4.8 | 4.7 | 4.7 |
| **Capital growth: % per year** | | | | | | | | | |
| Retail | -3.3 | 1.7 | -5.3 | -8.1 | -6.2 | -4.7 | 1.5 | 3.4 | -2.9 |
| Office | -1.7 | 3.6 | 2.1 | -2.5 | -5.7 | -5.0 | 0.3 | 3.6 | -1.9 |
| Industrial | 2.0 | 13.9 | 11.4 | -1.1 | -4.4 | -4.0 | 1.7 | 3.4 | -1.0 |
| All Property | -1.3 | 5.2 | 1.4 | -4.0 | -5.3 | -4.3 | 1.3 | 3.5 | -1.8 |
| **Nominal rental value growth: % per year** | | | | | | | | | |
| Retail | 1.0 | 1.1 | -2.2 | -2.1 | -0.7 | -0.8 | 0.0 | 1.0 | -0.5 |
| Office | 2.9 | 1.5 | 0.8 | 0.3 | -0.4 | -0.9 | -0.1 | 1.8 | 0.1 |
| Industrial | 3.5 | 5.3 | 4.6 | 2.8 | 2.3 | 1.2 | 0.3 | 0.2 | 1.4 |
| All Property | 2.1 | 2.2 | 0.5 | 0.0 | 0.2 | -0.2 | 0.2 | 1.1 | 0.3 |
| **Equivalent Yields - % at end year** | | | | | | | | | **Change pp** |
| Retail | 5.7 | 5.5 | 5.7 | 6.0 | 6.2 | 6.4 | 6.2 | 6.0 | 0.3 |
| Office | 6.0 | 5.8 | 5.6 | 5.7 | 5.9 | 6.1 | 5.9 | 5.7 | 0.1 |
| Industrial | 6.3 | 5.7 | 5.3 | 5.5 | 5.8 | 6.0 | 5.9 | 5.6 | 0.4 |
| All Property | 5.9 | 5.6 | 5.5 | 5.6 | 5.8 | 6.0 | 5.8 | 5.6 | 0.2 |

*Forecast figures based on Q1 2019 quarterly valuations

Source: CBRE, Q1 2019

In 2019 performance across sectors will be wide but narrowing over the forecast horizon. 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 0.3%, are expected to be lower than last year. This is owing primarily to an outward shift in retail yields. The industrial sector will 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 to fall 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 2.8% per annum.

Moderate rental growth is forecast in the office sector while industrial rental growth continues, albeit at a slower pace, and retail rental growth is negative on a five year basis. 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

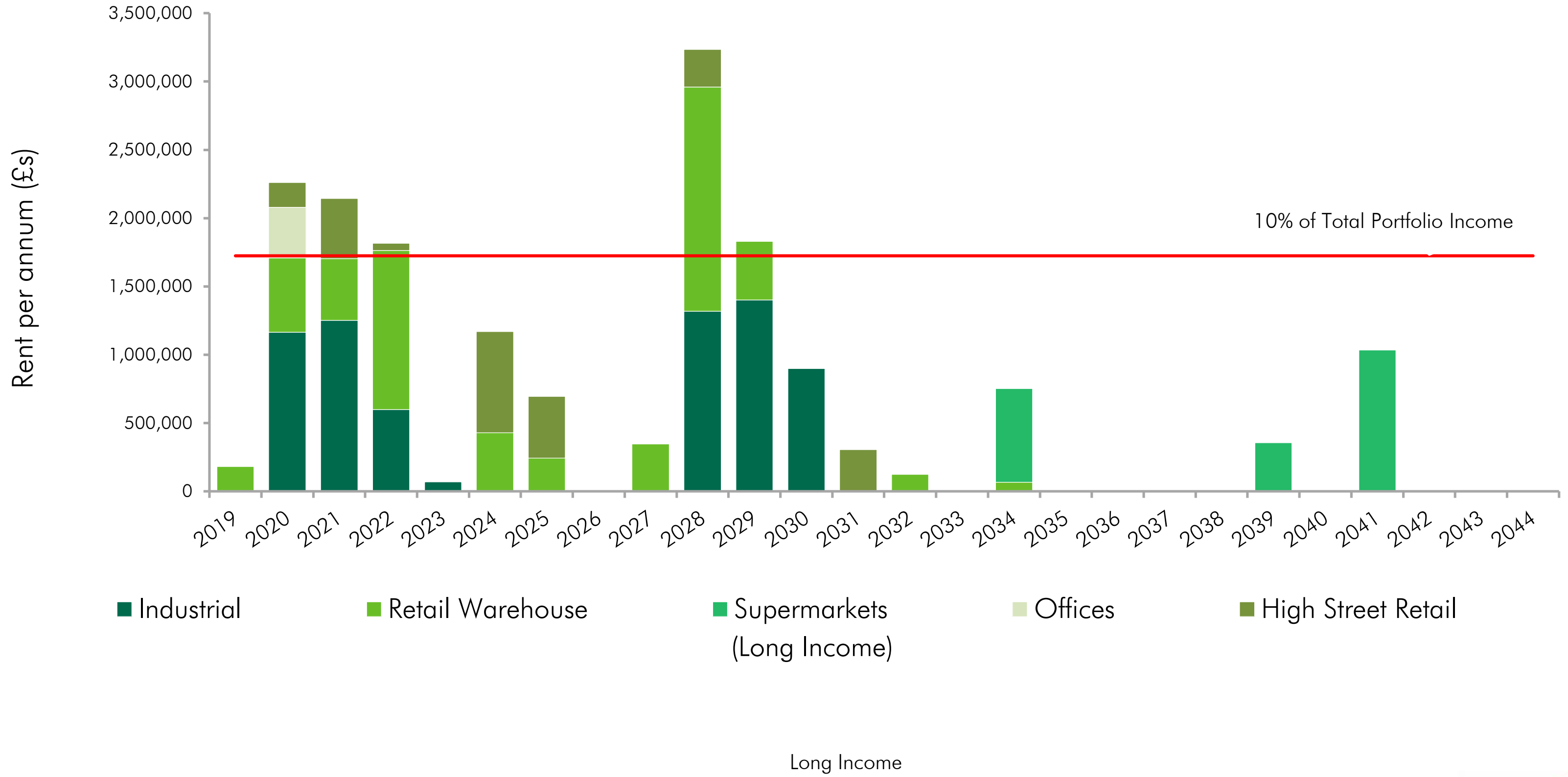
### Top Down Strategy

- The Teesside Pension Fund was valued at approximately £4.084bn in March 2019. The Direct Property Portfolio held by the Fund was valued at £292.4m, equating to 7.4% 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

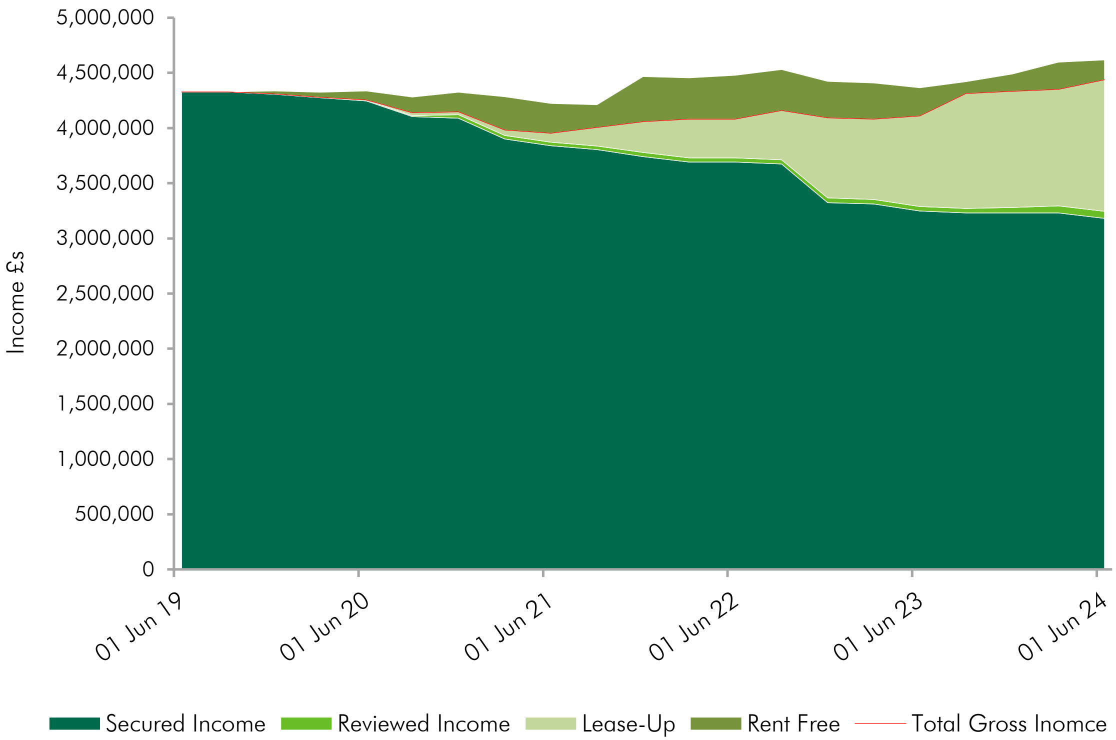





# PORTFOLIO POSITIONING AND FORECASTING

## 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 | 11.8% |
| South East | 9.7% |
| South West | 10.6% |
| East | 7.2% |
| West Midlands | 24.2% |
| North East | 30.5% |
| North West | 4.1% |
| Scotland | 1.9% |
| **Total** | **100%** |

| SECTOR | % OF PORTFOLIO (RENTAL VALUE) |
|---|---|
| Industrial | 40.6% |
| Retail Warehouse | 32.2% |
| High Street Retail | 14.3% |
| Long Income | 10.7% |
| Offices | 2.2% |
| **Total** | **100%** |

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# 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 | 8.12% | 1 | 09 September 2029 |
| 2 | Libra Textiles | 129,952 | £1,035,000 | £950,000 | 6.01% | 1 | 04 April 2041 |
| 3 | B&Q plc | 107,068 | £997,000 | £1,025,000 | 5.79% | 2 | 31 January 2027 |
| 4 | Royal Mail Group Limited | 207,572 | £899,162 | £1,000,000 | 5.22% | 1 | 23 September 2030 |
| 5 | DHL Supply Chain Ltd. | 146,138 | £868,635 | £875,000 | 5.04% | 1 | 28 September 2021 |
| 6 | Brunel Healthcare | 136,342 | £843,761 | £650,000 | 4.90% | 1 | 10 April 2028 |
| 7 | H&M | 32,501 | £740,000 | £740,000 | 4.29% | 1 | 23 June 2024 |
| 8 | Tesco Stores Limited | 25,084 | £686,011 | £570,000 | 3.98% | 1 | 28 July 2034 |
| 9 | P&O Ferrymasters Limited | 122,157 | £662,000 | £685,000 | 3.84% | 1 | 25 December 2020 |
| 10 | Matalan Retail Limited | 51,753 | £500,000 | £500,000 | 2.90% | 1 | 27 November 2028 |
| 11 | Halycon Fine Art Ltd | 38,722 | £475,000 | £500,000 | 2.76% | 1 | 22 December 2028 |
| 12 | Barclays | 18,833 | £450,000 | £450,000 | 2.61% | 1 | 23 June 2025 |
| 13 | HSBC Bank Plc | 2,016 | £440,000 | £460,000 | 2.55% | 1 | 18 October 2021 |
| 14 | Wickes Building Supplies Limited | 28,338 | £396,750 | £396,750 | 2.30% | 1 | 29 September 2028 |
| 15 | DSG Retail Limited (t/a Currys/PC World) | 25,000 | £375,000 | £375,000 | 2.18% | 1 | 28 September 2022 |
| 16 | B&M Retail Limited (t/a B&M Homestore) | 25,000 | £375,000 | £375,000 | 2.18% | 1 | 28 September 2022 |
| 17 | Institute of Cancer Research | 9,502 | £371,420 | £371,420 | 2.16% | 1 | 17 February 2020 |
| 18 | Nuffield Health | 26,458 | £354,715 | £331,000 | 2.06% | 1 | 04 April 2039 |
| 19 | Pets at Home Ltd | 15,577 | £325,825 | £302,500 | 1.89% | 2 | 05 January 2024 |
| 20 | Aurum Group Limited | 1,440 | £305,000 | £305,000 | 1.77% | 1 | 01 March 2031 |
| **TOTAL** | | **1,470,268** | **£12,500,279** | **£12,261,670** | **72.5%** | **22** | |

# 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. Following this, negotiations are ongoing with PureGym who have signified an interest in taking the unit vacated by 99p Stores.

### Bromford Central, Birmingham

- Wolseley UK Ltd have vacated Unit 4. CBRE Building Consultancy have specified and administered the repair works at the property. These have been carried out by Inco Contracts and have recently been completed. A schedule of dilapidations has been served on Wolseley UK Ltd, with negotiations ongoing. Interest has been received in the vacant unit.

### 123 Old Brompton Road, London

- The residential Property Manager is engaged to produce a schedule of repairs and cost estimate for consideration by the Tenants. A 'Notice of Intention' has been served on the Tenants. Surveyors are currently tendering for the works required and it is estimated that the works may being in October 2019.

### 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 24th December 2030. The rent is to be £140,000 pa, with a single upwards only rent at the 5th anniversary of the term.

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